WATERS CORP /DE/
Form 10-Q
November 04, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended October 1, 2011

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________.

Commission File Number: 01-14010

Waters Corporation

(Exact name of registrant as specified in its charter)

Delaware	**13-3668640**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

34 Maple Street
Milford, Massachusetts 01757
(Address, including zip code, of principal executive offices)
(508) 478-2000
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

Indicate the number of shares outstanding of the registrant s common stock as of October 28, 2011: 89,606,696

WATERS CORPORATION AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q
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WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	October 1, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 423,926	$ 308,498
Short-term investments	770,291	637,921
Accounts receivable, less allowances for doubtful accounts and sales returns of $7,009 and $6,196 at October 1, 2011 and December 31, 2010, respectively	354,445	358,237
Inventories	246,258	204,300
Other current assets	68,439	77,685
Total current assets	1,863,359	1,586,641
Property, plant and equipment, net	221,059	215,060
Intangible assets, net	196,305	181,316
Goodwill	298,297	291,657
Other assets	60,595	52,996
Total assets	$ 2,639,615	$ 2,327,670
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and debt	$ 271,578	$ 66,055
Accounts payable	64,393	64,406
Accrued employee compensation	39,209	52,831
Deferred revenue and customer advances	129,653	106,445
Accrued income taxes	25,959	11,909
Accrued warranty	12,496	11,272
Other current liabilities	62,291	72,932
Total current liabilities	605,579	385,850
Long-term liabilities:		
Long-term debt	700,000	700,000
Long-term portion of retirement benefits	71,952	72,624
Long-term income tax liability	77,537	77,764
Other long-term liabilities	25,464	22,635
Total long-term liabilities	874,953	873,023
Total liabilities	1,480,532	1,258,873
Commitments and contingencies (Notes 5, 6 and 10)		

Stockholders equity:				
Preferred stock, par value $0.01 per share, 5,000 shares authorized, none issued at October 1, 2011 and December 31, 2010				
Common stock, par value $0.01 per share, 400,000 shares authorized, 152,403 and 151,054 shares issued, 89,584 and 91,848 shares outstanding at October 1, 2011 and December 31, 2010, respectively		1,524		1,511
Additional paid-in capital		1,051,493		970,068
Retained earnings		2,914,300		2,618,479
Treasury stock, at cost, 62,819 and 59,206 shares at October 1, 2011 and December 31, 2010, respectively		(2,807,451)		(2,509,466)
Accumulated other comprehensive loss		(783)		(11,795)
Total stockholders equity		1,159,083		1,068,797
Total liabilities and stockholders equity	$	2,639,615	$	2,327,670

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Three Months Ended	
	October 1, 2011	October 2, 2010
Product sales	$ 321,348	$ 282,934
Service sales	133,186	118,104
Total net sales	454,534	401,038
Cost of product sales	124,228	113,345
Cost of service sales	56,090	49,640
Total cost of sales	180,318	162,985
Gross profit	274,216	238,053
Selling and administrative expenses	121,211	111,306
Research and development expenses	23,372	20,524
Purchased intangibles amortization	2,369	2,408
Operating income	127,264	103,815
Interest expense	(6,159)	(3,810)
Interest income	613	516
Income from operations before income taxes	121,718	100,521
Provision for income taxes	20,461	5,802
Net income	$ 101,257	$ 94,719
Net income per basic common share	$ 1.12	$ 1.03
Weighted-average number of basic common shares	90,688	91,714
Net income per diluted common share	$ 1.10	$ 1.02

Weighted-average number of diluted common shares and equivalents	92,060	93,286

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Nine Months Ended	
	October 1, 2011	October 2, 2010
Product sales	$ 940,834	$ 811,401
Service sales	388,930	348,392
Total net sales	1,329,764	1,159,793
Cost of product sales	361,409	317,640
Cost of service sales	164,841	146,410
Total cost of sales	526,250	464,050
Gross profit	803,514	695,743
Selling and administrative expenses	363,774	324,938
Research and development expenses	68,640	61,407
Purchased intangibles amortization	7,374	7,642
Operating income	363,726	301,756
Interest expense	(15,294)	(10,045)
Interest income	2,139	1,293
Income from operations before income taxes	350,571	293,004
Provision for income taxes	54,750	37,845
Net income	$ 295,821	$ 255,159
Net income per basic common share	$ 3.24	$ 2.75
Weighted-average number of basic common shares	91,334	92,647
Net income per diluted common share	$ 3.18	$ 2.71

Weighted-average number of diluted common shares and equivalents	92,898	94,271

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(unaudited)

	Nine Months Ended	
	October 1, 2011	October 2, 2010
Cash flows from operating activities:		
Net income	$ 295,821	$ 255,159
Adjustments to reconcile net income to net cash provided by operating activities:		
Provisions for doubtful accounts on accounts receivable	2,267	1,414
Provisions on inventory	7,477	7,309
Stock-based compensation	20,645	18,558
Deferred income taxes	(7,072)	(4,669)
Depreciation	27,267	25,897
Amortization of intangibles	22,778	19,621
Change in operating assets and liabilities:		
Decrease (increase) in accounts receivable	10,040	(20,713)
Increase in inventories	(46,235)	(35,771)
Decrease (increase) in other current assets	4,532	(1,325)
Increase in other assets	(4,023)	(1,256)
(Decrease) increase in accounts payable and other current liabilities	(11,937)	36,311
Increase in deferred revenue and customer advances	20,970	23,335
Increase (decrease) in other liabilities	4,782	(101)
Net cash provided by operating activities	347,312	323,769
Cash flows from investing activities:		
Additions to property, plant, equipment and software capitalization	(51,344)	(47,277)
Business acquisitions, net of cash acquired	(11,000)	
Purchase of short-term investments	(1,297,497)	(924,727)
Maturity of short-term investments	1,165,127	639,567
Net cash used in investing activities	(194,714)	(332,437)
Cash flows from financing activities:		
Proceeds from debt issuances	558,199	315,116
Payments on debt	(352,676)	(154,645)
Payments of debt issuance costs	(4,523)	(1,498)
Proceeds from stock plans	45,687	26,850
Purchase of treasury shares	(297,985)	(244,893)
Excess tax benefit related to stock option plans	15,316	5,149
Payments of debt swaps and other derivative contracts	(1,971)	(4,968)
Net cash used in financing activities	(37,953)	(58,889)
Effect of exchange rate changes on cash and cash equivalents	783	(10,762)
Increase (decrease) in cash and cash equivalents	115,428	(78,319)
Cash and cash equivalents at beginning of period	308,498	341,111

Cash and cash equivalents at end of period	$ 423,926	$ 262,792

The accompanying notes are an integral part of the interim consolidated financial statements.

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WATERS CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 Basis of Presentation and Summary of Significant Accounting Policies

Waters Corporation (Waters® or the Company), an analytical instrument manufacturer, primarily designs, manufactures, sells and services, through its Waters Division, high performance liquid chromatography (HPLC), ultra performance liquid chromatography (UPLC® and together with HPLC, referred to as LC) and mass spectrometry (MS) instrument systems and support products, including chromatography columns, other consumable products and comprehensive post-warranty service plans. These systems are complementary products that can be integrated together and used along with other analytical instruments. LC is a standard technique and is utilized in a broad range of industries to detect, identify, monitor and measure the chemical, physical and biological composition of materials, and to purify a full range of compounds. MS instruments are used in drug discovery and development, including clinical trial testing, the analysis of proteins in disease processes (known as proteomics), food safety analysis and environmental testing. LC is often combined with MS to create LC-MS instruments that include a liquid phase sample introduction and separation system with mass spectrometric compound identification and quantification. Through its TA Division (TA®), the Company primarily designs, manufactures, sells and services thermal analysis, rheometry and calorimetry instruments, which are used in predicting the suitability of fine chemicals, polymers and viscous liquids for various industrial products, consumer goods and healthcare products, as well as for life science research. The Company is also a developer and supplier of software-based products that interface with the Company s instruments and are typically purchased by customers as part of the instrument system.

The Company s interim fiscal quarter typically ends on the thirteenth Saturday of each quarter. Since the Company s fiscal year end is December 31, the first and fourth fiscal quarters will not consist of thirteen complete weeks. The Company s third fiscal quarters for 2011 and 2010 ended on October 1, 2011 and October 2, 2010, respectively.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the instructions to the Quarterly Report on Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles (GAAP) in the United States of America. The consolidated financial statements include the accounts of the Company and its subsidiaries, most of which are wholly owned. All material inter-company balances and transactions have been eliminated.

The preparation of consolidated financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities at the dates of the financial statements. Actual amounts may differ from these estimates under different assumptions or conditions.

It is management s opinion that the accompanying interim consolidated financial statements reflect all adjustments (which are normal and recurring) that are necessary for a fair statement of the results for the interim periods. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission on February 25, 2011.

During the second quarter of 2010, the Company identified an error originating in periods prior to December 31, 2009. The error relates to an overstatement of the Company s incentive plan and other accrual balances. The Company identified and corrected the error in the three months ended July 3, 2010 which reduced selling and administrative expense. The Company did not believe that the prior period error, individually or in the aggregate, was material to the nine months ended October 2, 2010 or any previously issued annual or quarterly financial statements.

Cash, Cash Equivalents and Short-Term Investments

The Company s cash equivalents primarily represent highly liquid investments, with original maturities of 90 days or less, primarily in bank deposits, and AAA rated U.S. treasury, Canadian treasury, commercial paper and European government bond money market funds, which are convertible to a known amount of cash and carry an insignificant risk of change in market value. Investments with longer maturities are classified as short-term investments, and are held primarily in bank deposits and U.S., Canadian, German, French and Dutch government treasury bills. As of October 1, 2011 and December 31, 2010, $1,130 million and $901 million, respectively, of our total cash, cash equivalents, and marketable securities were held by our foreign subsidiaries.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value Measurements

In accordance with the accounting standards for fair value measurements and disclosures, certain of the Company s assets and liabilities are measured at fair value on a recurring basis as of October 1, 2011 and December 31, 2010. Fair values determined by Level 1 inputs utilize observable data, such as quoted prices in active markets. Fair values determined by Level 2 inputs utilize data points other than quoted prices in active markets that are observable either directly or indirectly. Fair values determined by Level 3 inputs utilize unobservable data points for which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at October 1, 2011 (in thousands):

	Total at October 1, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 210,420	$	$ 210,420	$
Short-term investments	770,291		770,291	
Waters 401(k) Restoration Plan assets	19,079		19,079	
Foreign currency exchange contract agreements	218		218	
Total	$ 1,000,008	$	$ 1,000,008	$
Liabilities:				
Foreign currency exchange contract agreements	$ 108	$	$ 108	$
Total	$ 108	$	$ 108	$

The following table represents the Company s assets and liabilities measured at fair value on a recurring basis at December 31, 2010 (in thousands):

	Total at December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				

Cash equivalents	$	87,975	$		$	87,975	$	
Short-term investments		637,921				637,921		
Waters 401(k) Restoration Plan assets		19,988				19,988		
Foreign currency exchange contract agreements		424				424		
Total	$	746,308	$		$	746,308	$	
Liabilities:								
Foreign currency exchange contract agreements	$	626	$		$	626	$	
Total	$	626	$		$	626	$	

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s financial assets and liabilities have been classified as Level 2. These assets and liabilities have been initially valued at the transaction price and subsequently valued, typically utilizing third-party pricing services. The pricing services use many inputs to determine value, including reportable trades, benchmark yields, credit spreads, broker/dealer quotes, current spot rates and other industry and economic events. The Company validates the prices provided by third-party pricing services by reviewing their pricing methods and obtaining market values from other pricing sources. The fair values of the Company s cash equivalents, short-term investments, 401(k) restoration plan assets and foreign currency exchange contracts are determined through market and observable sources and have been classified as Level 2. After completing these validation procedures, the Company did not adjust or override any fair value measurements provided by third-party pricing services as of October 1, 2011 and December 31, 2010.

Fair Value of Other Financial Instruments

The Company s cash, accounts receivable, accounts payable and variable interest rate debt are recorded at cost, which approximates fair value. The carrying value and fair value of the Company s fixed interest rate debt is $400 million and $408 million, respectively, at October 1, 2011. The carrying value and fair value of the Company s fixed interest rate debt was $200 million and $203 million, respectively, at December 31, 2010.

Hedge Transactions

The Company operates on a global basis and is exposed to the risk that its earnings, cash flows and stockholders equity could be adversely impacted by fluctuations in currency exchange rates and interest rates.

The Company records its hedge transactions in accordance with the accounting standards for derivative instruments and hedging activities, which establish the accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the consolidated balance sheets at fair value as either assets or liabilities. If the derivative is designated as a fair-value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in earnings when the hedged item affects earnings; ineffective portions of changes in fair value are recognized in earnings. In addition, disclosures required for derivative instruments and hedging activities include the Company s objectives for using derivative instruments, the level of derivative activity the Company engages in, as well as how derivative instruments and related hedged items affect the Company s financial position and performance.

The Company currently uses derivative instruments to manage exposures to foreign currency and interest rate risks. The Company s objectives for holding derivatives are to minimize foreign currency and interest rate risk using the most effective methods to eliminate or reduce the impact of foreign currency and interest rate exposures. The Company documents all relationships between hedging instruments and hedged items and links all derivatives designated as fair-value, cash flow or net investment hedges to specific assets and liabilities on the consolidated balance sheets or to specific forecasted transactions. In addition, the Company considers the impact of its counterparties credit risk on the fair value of the contracts as well as the ability of each party to execute under the contracts. The Company also assesses and documents, both at the hedges inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows associated with the hedged items. The Company did not have any interest rate swap agreements in place at October 1, 2011 and December 31, 2010.

The Company enters into forward foreign exchange contracts, principally to hedge the impact of currency fluctuations on certain inter-company balances and short-term assets and liabilities. Principal hedged currencies include the Euro, Japanese Yen, British Pound and Singapore Dollar. The periods of these forward contracts typically range from one to three months and have varying notional amounts, which are intended to be consistent with changes in the underlying exposures. Gains and losses on these forward contracts are recorded in selling and administrative expenses in the consolidated statements of operations. At October 1, 2011 and December 31, 2010, the Company held forward foreign exchange contracts with notional amounts totaling $137 million and $136 million, respectively.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s foreign currency exchange contracts included in the consolidated balance sheets are classified as follows (in thousands):

	October 1, 2011	December 31, 2010
Other current assets	$ 218	$ 424
Other current liabilities	$ 108	$ 626

The following is a summary of the activity related to the forward foreign exchange contracts (in thousands):

	Three Months Ended		Nine Months Ended	
	October 1, 2011	October 2, 2010	October 1, 2011	October 2, 2010
Realized (losses) gains on closed contracts	$ (3,941)	$ 1,998	$ (1,971)	$ (4,968)
Unrealized gains (losses) on open contracts	160	(382)	312	(127)
Cumulative net pre-tax (losses) gains	$ (3,781)	$ 1,616	$ (1,659)	$ (5,095)

Stockholders Equity

The Company repurchased $292 million and $241 million of the Company s outstanding common stock during the nine months ended October 1, 2011 and October 2, 2010, respectively. In February 2011, the Company s Board of Directors authorized the Company to repurchase up to $500 million of its outstanding common stock over a two-year period. During the nine months ended October 1, 2011, the Company repurchased 2.9 million shares at a cost of $242 million under this program.

In February 2009, the Company s Board of Directors authorized the Company to repurchase up to $500 million of its outstanding common stock over a two-year period. During the nine months ended October 1, 2011 and October 2, 2010, the Company repurchased 0.7 million and 3.8 million shares at a cost of $50 million and $241 million, respectively, under this program. As of April 2, 2011, the Company repurchased an aggregate of 8.2 million shares of its common stock under the now expired February 2009 program for an aggregate cost of $499 million.

Product Warranty Costs

The Company accrues estimated product warranty costs at the time of sale, which are included in cost of sales in the consolidated statements of operations. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component supplies, the Company s warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. The amount of the accrued warranty liability is based on historical information, such as past experience, prior product failure rates, number of units repaired and estimated costs of material and labor. The liability is reviewed for reasonableness at least quarterly.

The following is a summary of the activity of the Company s accrued warranty liability for the nine months ended October 1, 2011 and October 2, 2010 (in thousands):