OWENS & MINOR INC/VA/
Form 10-Q
May 10, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
OR
¨ 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 1-9810

Owens & Minor, Inc.
(Exact name of Registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-1701843 (I.R.S. Employer Identification No.)
9120 Lockwood Boulevard, Mechanicsville, Virginia	23116
(Address of principal executive offices)	(Zip Code)
Post Office Box 27626, Richmond, Virginia	23261-7626
(Mailing address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code (804) 723-7000

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 x No ¨
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). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “larger accelerated filer”, “accelerated filer”, “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer ¨

Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company ¨
Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares of Owens & Minor, Inc.'s common stock outstanding as of May 7, 2018, was 61,791,911 shares.

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Owens & Minor, Inc. and Subsidiaries
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Part I. Financial Information
Item 1. Financial Statements
Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Income
(unaudited)

(in thousands, except per share data)	Three Months Ended March 31, 2018	2017
Net revenue	$2,372,579	$2,328,573
Cost of goods sold	2,047,892	2,047,393
Gross margin	324,687	281,180
Distribution, selling and administrative expenses	284,361	237,693
Acquisition-related and exit and realignment charges	14,760	8,942
Other operating (income) expense, net	1,349	(972)
Operating income	24,217	35,517
Interest expense, net	10,253	6,744
Income before income taxes	13,964	28,773
Income tax provision	5,813	9,988
Net income	$8,151	$18,785
Net income per common share: basic and diluted	$0.13	$0.31
Cash dividends per common share	$0.26	$0.2575

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months Ended March 31,	
(in thousands)	2018	2017
Net income	$8,151	$18,785
Other comprehensive income, net of tax:		
Currency translation adjustments (net of income tax of $0 in 2018 and 2017)	8,921	5,492
Change in unrecognized net periodic pension costs (net of income tax of $142 in 2018 and $226 in 2017)	380	236
Other (net of income tax of $0 in 2018 and 2017)	6	110
Total other comprehensive income, net of tax	9,307	5,838
Comprehensive income	$17,458	$24,623

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(in thousands, except per share data)	March 31, 2018	December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$87,632	$104,522
Accounts receivable, net of allowances of $17,925 and $16,280	778,155	758,936
Merchandise inventories	1,021,711	990,193
Other current assets	300,275	328,254
Total current assets	2,187,773	2,181,905
Property and equipment, net of accumulated depreciation of $248,482 and $239,581	207,042	206,490
Goodwill, net	715,445	713,811
Intangible assets, net	178,880	184,468
Other assets, net	102,414	89,619
Total assets	$3,391,554	$3,376,293
Liabilities and equity		
Current liabilities		
Accounts payable	$958,270	$947,572
Accrued payroll and related liabilities	30,480	30,416
Other current liabilities	337,230	331,745
Total current liabilities	1,325,980	1,309,733
Long-term debt, excluding current portion	897,071	900,744
Deferred income taxes	73,180	74,247
Other liabilities	76,405	76,090
Total liabilities	2,372,636	2,360,814
Commitments and contingencies		
Equity		
Common stock, par value $2 per share; authorized - 200,000 shares; issued and outstanding - 61,812 shares and 61,476 shares	123,624	122,952
Paid-in capital	228,273	226,937
Retained earnings	682,798	690,674
Accumulated other comprehensive loss	(15,777)	(25,084)
Total equity	1,018,918	1,015,479
Total liabilities and equity	$3,391,554	$3,376,293

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Three Months Ended March 31, 2018	2017
Operating activities:		
Net income	$8,151	$18,785
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Depreciation and amortization	17,911	12,558
Share-based compensation expense	3,035	2,511
Provision for losses on accounts receivable	1,073	(603)
Deferred income tax expense (benefit)	(1,482)	(825)
Changes in operating assets and liabilities:		
Accounts receivable	(18,519)	1,554
Merchandise inventories	(30,556)	(32,777)
Accounts payable	9,478	(7,341)
Net change in other assets and liabilities	28,904	(24,965)
Other, net	278	4,743
Cash provided by (used for) operating activities	18,273	(26,360)
Investing activities:		
Additions to property and equipment	(7,074)	(10,146)
Additions to computer software and intangible assets	(7,086)	(4,622)
Proceeds from sale of property and equipment	—	315
Cash used for investing activities	(14,160)	(14,453)
Financing activities:		
Borrowings (repayments) under revolving credit facility	(300)	—
Repayments of debt	(3,125)	—
Cash dividends paid	(16,074)	(15,740)
Other, net	(2,304)	(2,759)
Cash used for financing activities	(21,803)	(18,499)
Effect of exchange rate changes on cash and cash equivalents	800	991
Net increase (decrease) in cash and cash equivalents	(16,890)	(58,321)
Cash and cash equivalents at beginning of period	104,522	185,488
Cash and cash equivalents at end of period	$87,632	$127,167
Supplemental disclosure of cash flow information:		
Income taxes paid, net	$1,197	$2,825
Interest paid	$9,661	$6,183

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity
(unaudited)

(in thousands, except per share data)	Common Shares Outstanding	Common Stock ($2 par value)	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance December 31, 2016	61,031	$122,062	$219,955	$685,504	$ (67,483)	$960,038
Net income				18,785		18,785
Other comprehensive income (loss)					5,838	5,838
Dividends declared ($0.2575 per share)				(15,698)		(15,698)
Share-based compensation expense, exercises and other	171	341	653			994
Balance March 31, 2017	61,202	$122,403	$220,608	$688,591	$ (61,645)	$969,957
Balance December 31, 2017	61,476	$122,952	$226,937	$690,674	$ (25,084)	$1,015,479
Net income				8,151		8,151
Other comprehensive income (loss)					9,307	9,307
Dividends declared ($0.26 per share)				(16,027)		(16,027)
Share-based compensation expense, exercises and other	336	672	1,336			2,008
Balance March 31, 2018	61,812	$123,624	$228,273	$682,798	$ (15,777)	$1,018,918

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)
(in thousands, unless otherwise indicated)

Note 1—Basis of Presentation and Use of Estimates

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Owens & Minor, Inc. and the subsidiaries it controls (we, us, or our) and contain all adjustments (which are comprised only of normal recurring accruals and use of estimates) necessary to conform with U.S. generally accepted accounting principles (GAAP). All significant intercompany accounts and transactions have been eliminated. The results of operations for interim periods are not necessarily indicative of the results expected for the full year.

Recently, we have made certain changes to the leadership team, organizational structure, budgeting and financial reporting processes which drive changes to segment reporting. These changes align our operations into two distinct business units: Global Solutions and Global Products. Global Solutions (previously Domestic and International) is our U.S. and European distribution, logistics and value-added services business. Global Products (previously Proprietary Products) provides product-related solutions, including surgical and procedural kitting and sourcing. Beginning with the quarter ended March 31, 2018, we now report financial results using this two segment structure and have recast prior year segment results on the same basis.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make assumptions and estimates that affect reported amounts and related disclosures. Actual results may differ from these estimates.

Revenue Recognition

On January 1, 2018, we adopted ASC 606 Revenue from Contracts with Customers, which establishes principles for recognizing revenue and reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We applied the guidance using the modified retrospective transition method. The adoption of this guidance had no impact on the amount and timing of revenue recognized, therefore, no adjustments were recorded to our consolidated financial statements upon adoption.

Our revenue is primarily generated from sales contracts with customers. Under most of our distribution arrangements, our performance obligations are limited to delivery of products to a customer upon receipt of a purchase order. For these arrangements, we recognize revenue at the point in time when shipment is completed, as control passes to the customer upon product receipt.

Revenue for activity-based fees and other services is recognized over time as activities are performed. Depending on the specific contractual provisions and nature of the performance obligation, revenue from services may be recognized on a straight-line basis over the term of the service, on a proportional performance model, based on level of effort, or when final deliverables have been provided.

Our contracts sometimes allow for forms of variable consideration including rebates, incentives and performance guarantees. In these cases, we estimate the amount of consideration to which we will be entitled in exchange for transferring the product or service to the customer. Rebates and customer incentives are estimated based on contractual terms or historical experience and we maintain a liability for rebates or incentives that have been earned but are unpaid. The amount accrued for rebates and incentives due to customers was $14.8 million at March 31, 2018 and $13.0 million at December 31, 2017.

Additionally, we generate fees from arrangements that include performance targets related to cost-saving initiatives for customers that result from our supply-chain management services. Achievement against performance targets, measured in accordance with contractual terms, may result in additional fees paid to us or, if performance targets are not achieved, we may be obligated to refund or reduce a portion of our fees or to provide credits toward future purchases by the customer. For these arrangements, contingent revenue is deferred and recognized as the performance target is achieved and the applicable contingency is released. When we determine that a loss is probable under a contract, the estimated loss is accrued. The amount deferred under these arrangements is not material.

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For our direct to patient and home health agency sales, revenues are recorded based upon the estimated amounts due from patients and third-party payors. Third-party payors include federal and state agencies (under Medicare and Medicaid programs), managed care health plans and commercial insurance companies. Estimates of contractual allowances are based upon historical collection rates for the related payor agreements. The estimated reimbursement amounts are made on a payor-specific basis and are recorded based on the best information available regarding management's interpretation of the applicable laws, regulations and reimbursement terms.

In most cases, we record revenue gross, as we are the primary obligor in the arrangement and we obtain control of the products before they are transferred to the customer. When we act as an agent in a sales arrangement and do not bear a significant portion of inventory risks, primarily for our third-party logistics business, we record revenue net of product cost. Sales taxes collected from customers and remitted to governmental authorities are excluded from revenues.

See Note 13 for disaggregation of revenue by segment and geography as we believe that best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors.

Note 2—Fair Value

The carrying amounts of cash and cash equivalents, accounts receivable, financing receivables, accounts payable and financing payables included in the consolidated balance sheets approximate fair value due to the short-term nature of these instruments. The fair value of long-term debt is estimated based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market (Level 1) or, if quoted market prices or dealer quotes are not available, on the borrowing rates currently available for loans with similar terms, credit ratings and average remaining maturities (Level 2). We determine the fair value of our derivatives, if any, based on estimated amounts that would be received or paid to terminate the contracts at the reporting date based on current market prices for applicable currencies. See Note 8 for the fair value of long-term debt.

Note 3—Acquisitions

On August 1, 2017, we completed the acquisition of Byram Healthcare, a leading domestic distributor of reimbursable medical supplies sold directly to patients and home health agencies.

The consideration was $367 million, net of cash acquired, which is subject to final working capital adjustments with the seller. The purchase price was allocated on a preliminary basis to the underlying assets acquired and liabilities assumed based upon our current estimate of their fair values at the date of acquisition. The purchase price exceeded the preliminary estimated fair value of the net tangible and identifiable intangible assets by $289 million which was allocated to goodwill. The following table presents the preliminary estimated fair value of the assets acquired and liabilities assumed recognized as of the acquisition date. The fair value of intangibles from this acquisition was primarily determined by applying the income approach, using several significant unobservable inputs for projected cash flows and a discount rate. These inputs are considered Level 3 inputs. The allocation of purchase price to assets and liabilities acquired is not yet complete, as final working capital adjustments with the seller are still pending.

	Preliminary Fair Value Originally Estimated as of Acquisition Date (1)	Differences Between Prior and the Current Periods Preliminary Fair Value Estimate	Preliminary Fair Value Currently Estimated as of Acquisition Date
Assets acquired:			
Current assets	$ 61,986	$ —	$ 61,986
Goodwill	288,691	—	288,691
Intangible assets	115,000	—	115,000
Other noncurrent assets			