BIOMET INC
Form 10-Q
January 13, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended November 30, 2003.

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 0-12515.

BIOMET, INC.
(Exact name of registrant as specified in its charter)

Indiana	35-1418342
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

56 East Bell Drive, Warsaw, Indiana 46582
(Address of principal executive offices)

(574) 267-6639
(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 X No

As of November 30, 2003, the registrant had 255,819,567 common shares outstanding.

BIOMET, INC.

CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BIOMET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
at November 30, 2003 and May 31, 2003
(in thousands)

ASSETS

	November 30, 2003 (Unaudited)	May 31, 2003
Current assets:		
Cash and cash equivalents	$ 241,740	$ 225,650
Investments	15,541	37,337
Accounts and notes receivable, net	439,312	418,095
Inventories	375,929	356,270
Deferred income taxes	54,642	54,262
Prepaid expenses and other	26,063	20,141
Total current assets	1,153,227	1,111,755
Property, plant and equipment, at cost	496,818	468,965
Less, Accumulated depreciation	239,320	215,519
Property, plant and equipment, net	257,498	253,446
Investments	186,486	155,607
Goodwill, net	127,738	126,706
Intangible assets, net	12,376	10,874
Other assets	13,624	13,781
Total assets	$1,750,949	$1,672,169

The accompanying notes are a part of the consolidated financial statements.

BIOMET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
at November 30, 2003 and May 31, 2003
(in thousands)

LIABILITIES AND SHAREHOLDERS' EQUITY

	November 30, 2003 (Unaudited)	May 31, 2003
Current liabilities:		
Short-term borrowings	$ 123,648	$ 114,120
Accounts payable	39,097	42,106
Accrued income taxes	10,002	12,453
Accrued wages and commissions	43,502	43,715
Other accrued expenses	57,351	54,260
Total current liabilities	273,600	266,654
Long-term liabilities:		
Deferred income taxes	6,918	7,031
Other liabilities	--	462
Total liabilities	280,518	274,147
Minority interest	116,032	111,888
Contingencies (Note 7)		
Shareholders' equity:		
Common shares	153,798	141,931
Additional paid-in capital	54,123	54,081
Retained earnings	1,144,336	1,100,462
Accumulated other comprehensive income (loss)	2,142	(10,340)
Total shareholders' equity	1,354,399	1,286,134
Total liabilities and shareholders' equity	$1,750,949	$1,672,169

The accompanying notes are a part of the consolidated financial statements.

BIOMET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
for the six and three month periods ended November 30, 2003 and 2002
(Unaudited, in thousands, except per share data)

	Six Months Ended		Three Months Ended	
	2003	2002	2003	2002
Net sales	$757,880	$659,048	$387,561	$341,448
Cost of sales	214,408	188,742	108,790	98,605
Gross profit	543,472	470,306	278,771	242,843
Selling, general and administrative expenses	269,061	237,137	136,664	121,249

Research and development expense	30,558	25,707	15,810	13,069
Operating income	243,853	207,462	126,297	108,525
Other income, net	6,690	6,802	3,669	2,858
Income before income taxes and minority interest	250,543	214,264	129,966	111,383
Provision for income taxes	87,229	74,138	45,250	38,544
Income before minority interest	163,314	140,126	84,716	72,839
Minority interest	4,144	3,766	2,024	2,485
Net income	$159,170	$136,360	$ 82,692	$ 70,354
Earnings per share:				
Basic	$.62	$.52	$.32	$.27
Diluted	$.62	$.52	$.32	$.27
Shares used in the computation of earnings per share:				
Basic	256,325	260,862	255,797	259,499
Diluted	257,904	262,925	257,599	261,626
Cash dividends per common share	$.15	$.10	$ --	$ --

The accompanying notes are a part of the consolidated financial statements.

BIOMET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the six months ended November 30, 2003 and 2002
(Unaudited, in thousands)

	2003	2002
Cash flows from (used in) operating activities:		
Net income	$159,170	$136,360
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	24,036	20,401
Amortization	1,512	1,944
Gain on sale of investments, net	(692)	(59)
Minority interest	4,144	3,766
Deferred income taxes	(1,103)	(967)
Changes in current assets and liabilities:		
Accounts and notes receivable, net	(16,819)	(15,788)
Inventories	(9,799)	(11,195)
Accounts payable	(7,089)	1,097
Accrued income taxes	(2,620)	(10,762)
Other	(1,425)	(5,684)
Net cash from operating activities	149,315	119,113
Cash flows from (used in) investing activities:		
Proceeds from sales and maturities of investments	68,981	74,650
Purchases of investments	(77,237)	(31,919)
Capital expenditures	(24,618)	(19,083)

Other	(1,878)	(3,614)
Net cash from (used in) investing activities	(34,752)	20,034
Cash flows from (used in) financing activities:		
Increase in short-term borrowings, net	6,877	12,043
Issuance of common shares	13,323	9,944
Cash dividends	(38,604)	(26,431)
Purchase of common shares	(78,703)	(148,264)
Net cash used in financing activities	(97,107)	(152,708)
Effect of exchange rate changes on cash	(1,366)	785
Increase (decrease) in cash and cash equivalents	16,090	(12,776)
Cash and cash equivalents, beginning of year	225,650	154,297
Cash and cash equivalents, end of period	$241,740	$141,521

The accompanying notes are a part of the consolidated financial statements.

BIOMET, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION.

The accompanying consolidated financial statements include the accounts of Biomet, Inc. and its subsidiaries (individually and collectively referred to as the "Company"). The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six-month period ended November 30, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending May 31, 2004. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2003.

The accompanying consolidated balance sheet at May 31, 2003, has been derived from the audited Consolidated Financial Statements at that date, but does not include all disclosures required by accounting principles generally accepted in the United States.

The Company operates in one business segment, musculoskeletal products, which includes the designing, manufacturing and marketing of reconstructive products, fixation devices, spinal products and other products. Other products consist primarily of EBI's softgoods and bracing products, Arthrotek's arthroscopy products, general instruments and operating room supplies. The Company manages its business segment primarily on a geographic basis. These geographic markets are comprised of the United States, Europe and the Rest of World. Major markets included in the Rest of World geographic market are Canada, South America, Mexico, Japan and the Pacific Rim.

Net sales of musculoskeletal products by product category are as follows for the six and three month periods ended November 30:

	Six Months Ended 2003	Six Months Ended 2002	Three Months Ended 2003	Three Months Ended 2002
	(in thousands)			
Reconstructive	$485,522	$403,939	$252,083	$211,914
Fixation	122,428	117,808	60,295	58,427
Spinal products	76,946	69,463	38,979	36,197
Other	72,984	67,838	36,204	34,910
	$757,880	$659,048	$387,561	$341,448

As permitted by SFAS No. 123, the Company accounts for its employee stock options using the intrinsic value method. Accordingly, no compensation expense is recognized for the employee stock-based compensation plans. If compensation expense for the Company's employee stock options had been determined based on the fair value method of accounting, pro forma net income and diluted earnings per share for the six and three month periods ended November 30, 2003 and 2002 would have been as follows:

	Six Months Ended 2003	Six Months Ended 2002	Three Months Ended 2003	Three Months Ended 2002
Net income as reported (in thousands)	$159,170	$136,360	$ 82,692	$ 70,354
Deduct: Total stock-based employee compensation espense determined under the fair value method for all awards net of related tax effects (in thousands)	2,563	2,764	1,281	1,382
Pro forma net income (in thousands)	$156,607	$133,596	$ 81,411	$ 68,972
Earning per share:				
Basic, as reported	$0.62	$0.52	$0.32	$0.27
Basic, pro forma	$0.61	$0.51	$0.32	$0.26
Diluted, as reported	$0.62	$0.52	$0.32	$0.27
Diluted, pro forma	$0.61	$0.51	$0.32	$0.27

NOTE 2: COMPREHENSIVE INCOME.

Other comprehensive income includes foreign currency translation adjustments and unrealized appreciation of available-for-sale securities, net of taxes. Other comprehensive income (loss) for the three months ended November 30, 2003 and 2002 was $9,884,000 and $(4,000), respectively. Other comprehensive income for the six months ended November 30, 2003 and 2002 was $12,483,000 and $16,676,000, respectively. Total comprehensive income combines reported net income and other comprehensive income. Total comprehensive income for the three months ended November 30, 2003 and 2002 was $92,576,000 and $70,350,000, respectively. Total comprehensive income for the six months ended November 30, 2003 and 2002 was $171,653,000 and $153,036,000, respectively.

NOTE 3: INVENTORIES.

Inventories at November 30, 2003 and May 31, 2003 are as follows:

	November 30, 2003	May 31, 2003
	(in thousands)	
Raw materials	$ 36,903	$ 37,685
Work-in-process	40,513	38,110
Finished goods	153,762	142,483
Consigned distributor	144,751	137,992
	$375,929	$356,270

NOTE 4: COMMON SHARES.

During the six months ended November 30, 2003, the Company issued 995,133 Common Shares upon the exercise of outstanding stock options for proceeds aggregating $13,323,000. Purchases of Common Shares pursuant to the Common Share Repurchase Programs aggregated 2,664,249 shares for $78,703,000 during the six months ended November 30, 2003.

NOTE 5: EARNINGS PER SHARE.

Earnings per common share amounts ("basic EPS") are computed by dividing net income by the weighted average number of common shares outstanding and excludes any potential dilution. Earnings per common share amounts assuming dilution ("diluted EPS") are computed by reflecting potential dilution from the exercise of stock options.

NOTE 6: INCOME TAXES.

The difference between the reported provision for income taxes and a provision computed by applying the federal statutory rate to pre-tax accounting income is primarily attributable to state income taxes, tax benefits relating to operations in Puerto Rico, tax-exempt income and tax credits.

NOTE 7: CONTINGENCIES.

There are various claims, lawsuits, disputes with third parties, investigations and pending actions involving various allegations against the Company incident to the operation of its business, principally product liability and intellectual property cases. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be resolved unfavorably to the Company. The Company establishes accruals for losses that are deemed to be probable and subject to reasonable estimate. Based on the advice of counsel to the Company in these matters, management believes that the ultimate outcome of these matters and any liabilities in excess of amounts provided will not have a material adverse impact on the Company's consolidated financial position or on its future business operations.

NOTE 8: SUBSEQUENT EVENTS.

On December 18, 2003, the Company announced that it had reached an agreement in principle with Merck KGaA, Darmstadt, Germany, to acquire Merck's 50% interest in the Biomet-Merck Joint Venture for an aggregate purchase price of $300 million in cash. Consummation of the acquisition, which is subject to certain conditions including completion of definitive documentation and clearance by applicable antitrust authorities, is expected to occur during the first calendar quarter of 2004.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION AS OF NOVEMBER 30, 2003

The Company's cash and investments increased $25,173,000 to $443,767,000 at November 30, 2003. This increase resulted from positive cash flow from operations, offset by the $38,604,000 dividend paid during the first quarter and the $78,703,000 used to purchase shares during the first six months pursuant to the Company's share repurchase programs.

Cash flows provided by operating activities were $149,315,000 for the first six months of fiscal 2004 compared to $119,113,000 in 2003. The primary sources of fiscal year 2004 cash flows from operating activities were net income and depreciation. The primary uses were increases in accounts receivable and inventory and a reduction in accounts payable. Over the last several quarters, the Company has experienced a greater sales growth in its insurance billings versus its hospital billings in the United States. These insurance billings historically have had a longer collection cycle. In addition, accounts receivable continue to increase as the Company's sales continue to grow. Inventories increased from new product introductions (specifically in Europe) and a buildup of inventory associated with the Company's establishment of its direct operations in Japan. Accounts payable decreased due to the lower levels of common stock being purchased at the end of this quarter versus the end of the fiscal year. Accounts and notes receivable and inventory balances were increased during the six month period by $4.4 million and $9.9 million, respectively, due to currency exchange rates.

Cash flows used in investing activities were $34,752,000 for the first six months of fiscal 2004 compared to cash flows provided of $20,034,000 in 2003. The primary use of cash flows from investing activities were purchases of investments and capital equipment offset by sales and maturities of investments.

Cash flows used in financing activities were $97,107,000 for the first six months of fiscal 2004 compared to a use of $152,708,000 in 2003. The primary use of cash flows from financing activities were the cash dividend paid in the first quarter and the share repurchase programs. In July 2003, the Company's Board of Directors declared a cash dividend of fifteen cents ($.15) per share payable to shareholders of record at the close of business on July 11, 2003.

Currently available funds, together with anticipated cash flows generated from future operations, are believed to be adequate to cover the Company's anticipated cash requirements, including the purchase of Merck's KGaA's 50% interest in the Biomet-Merck Joint Venture (see Footnote 8 in the Notes to Consolidated Financial Statements), capital expenditures, research and development costs, stock repurchases and litigation settlements, if any.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED NOVEMBER 30, 2003
AS COMPARED TO THE SIX MONTHS ENDED NOVEMBER 30, 2002

Net sales increased 15% to $757,880,000 for the six-month period ended November 30, 2003, from $659,048,000 for the same period last year. Excluding the impact of foreign currency, which increased sales for the six months by $28.4 million, net sales increased 11% during the first six months of fiscal year 2004. The Company's U.S.-based revenue increased 11% to $516,797,000 during the first six months of fiscal 2004, while foreign sales increased 25% to $241,083,000. Excluding the positive foreign exchange adjustment, foreign sales in local currencies increased 11%. The Company's worldwide sales of reconstructive products during the first six months of fiscal 2004 were $485,522,000, representing a 20% increase compared to the first six months of last year. This increase came through balanced growth in all of the reconstructive product categories. The Company's extensive line of reconstructive products continues to gain market share in this rapidly growing market. Sales of fixation products were $122,428,000 for the first six months of fiscal 2004, representing a 4% increase as compared to the same period in 2003. Sales of spinal products were $76,946,000 for the first six months of fiscal 2004, representing an 11% increase as compared to the same period in 2003. The increase is primarily a result of the expansion of EBI's product portfolio into the hardware and biological segments of the spinal markets. The Company's sales of other products totaled $72,984,000, representing an 8% increase over the first six months of fiscal year 2003, primarily as a result of increased sales of arthroscopy products and softgoods and bracing products.

Cost of sales decreased as a percentage of net sales to 28.3% for the first six months of fiscal 2004 from 28.6% last year primarily as a result of increased in-house manufacturing efficiencies. Selling, general and administrative expenses as a percentage of net sales decreased to 35.5% compared to 36.0% for the first six months last year. This decrease in the percentage is a result of the Company's continued emphasis on slowing its general and administrative expense growth. Research and development expenditures increased 19% during the first six months to $30,558,000 reflecting the Company's continued emphasis on new product introductions. Operating income rose 18% from $207,462,000 for the first six months of fiscal 2003, to $243,853,000 for the first six months of fiscal 2004. Other income decreased 1.6%. Over the last eight quarters, the Company has used $508,000,000 to purchase its common stock which has reduced cash available for investment. In addition, as interest rates fall, higher yielding investments are called and replaced with lower yielding investments. The effective income tax rate increased to 34.8% for the first six months of fiscal year 2004 from 34.6% last year primarily as a result of increases in domestic state income tax rates.

These factors resulted in a 17% increase in net income to $159,170,000 for the first six months of fiscal 2004 as compared to $136,360,000 for the same period in fiscal 2003. Basic and diluted earnings per share increased 19%, from $.52 to $.62 for the periods presented.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED NOVEMBER 30, 2003
AS COMPARED TO THE THREE MONTHS ENDED NOVEMBER 30, 2002

Net sales increased 14% to $387,561,000 for the second quarter of fiscal 2004, as compared to $341,448,000 for the same period last year. Excluding the impact of foreign currency, which increased second quarter sales by $13 million, net sales increased 10% during the second quarter of fiscal year 2004. Operating income increased 16% from $108,525,000 for the second quarter of fiscal 2003, to $126,297,000 for the second quarter of fiscal 2004. During the second quarter, net income increased 18% to $82,692,000 as compared to $70,354,000 for the same period last year. Basic and diluted earnings per share increased 19% from $.27 to $.32 for the periods presented. The business factors resulting in these changes and relevant trends affecting the Company's business during the periods in question are comparable to those described in the preceding discussion for the six-month period.

Item 3. Quantitative and Qualitative Disclosures about Market Risks.

There have been no material changes from the information provided in the Company's Annual Report on Form 10-K for the year ended May 31, 2003.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in timely notification to them of information the Company is required to disclose in its periodic SEC filings and in ensuring that this information is recorded, processed summarized and reported within the time periods specified in the SEC's rules and regulations.

(b) Changes in Internal Control. During the second quarter of fiscal 2004 covered by this report, there have been no significant changes in internal control over financial reporting that have materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits. See Index to Exhibits.
(b) Reports on Form 8-K. None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIOMET, INC.

DATE: 1/13/2004

BY: /s/ Gregory D. Hartman

Gregory D. Hartman
Senior Vice President - Finance
(Principal Financial Officer)

(Signing on behalf of the registrant and as principal financial officer)

BIOMET, INC.

FORM 10-Q

INDEX TO EXHIBITS

Number Assigned in Regulation S-K Item 601	Description of Exhibit	Sequential Numbering System Page Number of Exhibit
(2)	No exhibit	
(4)	4.1 Specimen certificate for Common Shares. (Incorporated by reference to	

	Exhibit 4.1 to the registrant's Report on Form 10-K for the fiscal year ended May 31, 1985.)
	4.2 Rights Agreement between Biomet, Inc. and Lake City Bank, as Rights Agent, dated as of December 16, 1999. (Incorporated by reference to Exhibit 4.01 to Biomet, Inc. Form 8-K Current Report dated December 16, 1999, Commission File No. 0-12515), as amended September 1, 2002 to change rights agent to American Stock Transfer & Trust Company.
(10)	10.1 Joint Venture Agreement between Biomet, Inc. and Merck KGaA dated as of November 24, 1997 (Incorporated by reference to Exhibit 2.01 to Biomet, Inc. Form 8-K Current Report dated February 17, 1998, Commission File No. 0-12515).
(11)	No exhibit
(15)	No exhibit.
(18)	No exhibit.
(19)	No exhibit.
(22)	No exhibit.
(23)	No exhibit.
(24)	No exhibit.
(31)	31.1 Certification of Chief Exectuive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
	31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(32)	32.1 Written Statement of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.