

QUIDEL CORP /DE/
Form 10-Q
July 30, 2010

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

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: 0-10961

QUIDEL CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

94-2573850

(I.R.S. Employer
Identification No.)

10165 McKellar Court, San Diego, California 92121

(Address of principal executive offices, including zip code)

(858) 552-1100

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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. (Check one):

Large accelerated
filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller reporting company)

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

As of July 27, 2010, 28,493,971 shares of common stock were outstanding.

INDEX

<u>PART I FINANCIAL INFORMATION</u>	3
<u>ITEM 1. Financial Statements (unaudited)</u>	3
<u>Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009</u>	4
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>ITEM 4. Controls and Procedures</u>	20
<u>PART II OTHER INFORMATION</u>	21
<u>ITEM 1. Legal Proceedings</u>	21
<u>ITEM 1A. Risk Factors</u>	21
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
<u>ITEM 5. Other Information</u>	21
<u>ITEM 6. Exhibits</u>	21
<u>Signatures</u>	23
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements**

QUIDEL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except par value; unaudited)

	June 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,831	\$ 89,003
Marketable securities		3,999
Accounts receivable, net	10,235	9,717
Inventories	19,918	15,038
Deferred tax asset - current	13,383	6,018
Refundable income taxes	3,092	
Prepaid expenses and other current assets	3,118	2,448
Total current assets	64,577	126,223
Property and equipment, net	29,314	21,251
Goodwill	70,827	6,470
Intangible assets, net	54,666	1,943
Deferred tax asset - non-current		9,065
Other non-current assets	1,706	1,393
Total assets	\$ 221,090	\$ 166,345
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 5,884	\$ 5,212
Accrued payroll and related expenses	4,297	5,187
Accrued royalties	1,650	5,513
Current portion of lease obligation	241	234
Income taxes payable		6,151
Other current liabilities	4,884	7,227
Total current liabilities	16,956	29,524
Long term debt	76,604	
Lease obligation, net of current portion	6,709	6,527
Deferred tax liability - non-current	560	
Income taxes payable	2,360	2,360
Other non-current liabilities	2,148	1,484
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.001 par value per share; 5,000 shares authorized; none issued or outstanding at June 30, 2010 and December 31, 2009		
Common stock, \$.001 par value per share; 50,000 shares authorized; 28,494 and 29,026 shares issued and outstanding at June 30, 2010 and December 31, 2009,	28	29

respectively		
Additional paid-in capital	106,749	112,426
Accumulated other comprehensive income		34
Retained earnings	8,976	13,961
Total stockholders' equity	115,753	126,450
Total liabilities and stockholders' equity	\$ 221,090	\$ 166,345

See accompanying notes.

3

Table of Contents

QUIDEL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data; unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Total revenues	\$ 25,026	\$ 24,643	\$ 53,405	\$ 41,533
Costs and expenses				
Cost of sales (excludes amortization of intangible assets of \$1.6 million, \$0.3 million, \$2.4 million and \$0.6 million, respectively)	12,237	10,075	24,871	18,499
Amortization of inventory fair value adjustment from acquisition	399		1,118	
Total cost of sales (excludes amortization of intangible assets of \$1.6 million, \$0.3 million, \$2.4 million and \$0.6 million, respectively)	12,636	10,075	25,989	18,499
Research and development	6,349	2,950	12,624	5,846
Sales and marketing	6,272	5,403	12,271	10,138
General and administrative	4,792	3,680	9,033	7,800
Amortization of intangible assets from acquired businesses	1,467		2,119	
Amortization of intangible assets from licensed technology	324	347	648	695
Business acquisition and integration costs, and restructuring charges	716	1,085	2,066	2,038
Total costs and expenses	32,556	23,540	64,750	45,016
Operating (loss) income	(7,530)	1,103	(11,345)	(3,483)
Other (expense) income				
Interest income	11	93	180	246
Interest expense	(611)	(153)	(1,010)	(311)
Total other (expense) income	(600)	(60)	(830)	(65)
(Loss) income before taxes	(8,130)	1,043	(12,175)	(3,548)
(Benefit) provision for income taxes	(5,663)	406	(7,191)	(1,384)
Net (loss) income	\$ (2,467)	\$ 637	\$ (4,984)	\$ (2,164)
Basic and diluted (loss) earnings per share	\$ (0.09)	\$ 0.02	\$ (0.18)	\$ (0.07)
Shares used in basic per share calculation	28,406	29,677	28,457	30,373
Shares used in diluted per share calculation	28,406	30,063	28,457	30,373

See accompanying notes.

Table of Contents

QUIDEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands; unaudited)

	Six months ended	
	June 30,	
	2010	2009
OPERATING ACTIVITIES:		
Net loss	\$ (4,984)	\$ (2,164)
Adjustments to reconcile net loss to net cash (used for) provided by operating activities:		
Depreciation, amortization and other	5,455	2,866
Stock-based compensation expense	2,625	1,715
Gain on sale of assets	2	
Deferred tax asset	(7,159)	(1,384)
Changes in assets and liabilities:		
Accounts receivable	6,321	16,512
Inventories	209	(187)
Income tax receivable	840	
Prepaid expenses and other current assets	110	(727)
Accounts payable	(1,461)	(1,703)
Accrued payroll and related expenses	(1,369)	721
Accrued royalties	(4,127)	(664)
Accrued income taxes payable	(6,151)	
Other current and non-current liabilities	(4,368)	(3,095)
Net cash (used for) provided by operating activities	(14,057)	11,890
INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(2,325)	(1,589)
Purchase of business, net of cash acquired of \$3.1 million	(128,093)	
Proceeds from sale of marketable securities	3,999	
Other assets	(225)	(54)
Net cash used for investing activities	(126,644)	(1,643)
FINANCING ACTIVITIES:		
Payments on lease obligation	(100)	(421)
Purchases of common stock	(9,181)	(19,542)
Borrowing from line of credit	75,000	
Proceeds from issuance of common stock, net of cancellations	878	1,241
Other	(68)	
Net cash provided by (used for) financing activities	66,529	(18,722)
Net decrease in cash and cash equivalents	(74,172)	(8,475)
Cash and cash equivalents, beginning of period	89,003	57,908

Cash and cash equivalents, end of period	\$ 14,831	\$ 49,433
--	-----------	-----------

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for interest	\$ 1,011	\$ 311
--	----------	--------

Cash paid during the period for income taxes	\$ 6,500	\$ 200
--	----------	--------

NON-CASH INVESTING ACTIVITIES:

Purchase of capital equipment by incurring current liabilities	\$ 436	\$
--	--------	----

See accompanying notes.

5

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Quidel Corporation and its subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. The information at June 30, 2010, and for the three and six months ended June 30, 2010 and 2009, is unaudited. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2009 included in the Company's 2009 Annual Report on Form 10-K. Subsequent events have been evaluated up to and including the date these financial statements were issued.

For 2010 and 2009, the Company's fiscal year will or has ended on January 2, 2011 and January 3, 2010, respectively. For 2010 and 2009, the Company's second quarter ended on July 4, 2010 and June 28, 2009, respectively. For ease of reference, the calendar quarter end dates are used herein. The three and six month periods ended June 30, 2010 and 2009 both included 13 weeks and 26 weeks, respectively.

Note 2. Acquisition

On February 19, 2010, the Company acquired Diagnostic Hybrids, Inc. (DHI) a privately-held, *in vitro* diagnostics (IVD) company, based in Athens, Ohio, that is a market leader in the manufacturing and commercialization of FDA-cleared direct and culture-based fluorescent IVD assays used in hospital and reference laboratories for a variety of diseases, including viral respiratory infections, herpes, Chlamydia and other viral infections, and thyroid diseases. DHI's direct sales force serves over 700 North American customers, and its products are sold via distributors outside the United States. DHI's products are offered under various brand names including, among others, ELVIS[®], R-Mix[®], Mixed Fresh Cells[®], FreshCells[®], ReadyCells[®] and Thyretain[®]. The Company paid approximately \$131.2 million in cash to acquire DHI. The Company paid for the acquisition of DHI using cash and cash equivalents on hand and borrowing \$75.0 million under the Senior Credit Facility (as defined below). Included in the consolidated statements of operations for the six months ended June 30, 2010 is revenue and net loss of \$14.9 million and \$0.2 million, respectively, related to the operations of DHI since acquisition. Net loss of \$0.2 million includes the amortization of acquired intangibles and interest expense on the borrowing under the Company's Senior Credit Facility.

The purchase price of DHI is allocated to the underlying net assets acquired and liabilities assumed based on their respective fair values as of February 19, 2010 with any excess purchase price allocated to goodwill. The Company's preliminary allocation of the purchase price to the net tangible and intangible assets acquired and liabilities assumed as of June 30, 2010 is as follows:

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Note 2. Acquisition (Continued)**(in thousands)**

Total cash consideration	\$ 131,212
Allocated to:	
Current assets	27,042
Property, plant and equipment	7,799
Other non-current assets	82
In-process research and development	2,110
Intangible assets	53,410
Current liabilities (excluding current portion of note payable)	(4,172)
Note payable to state agency	(1,882)
Other non-current liabilities	(17,534)
Goodwill	64,357
Net assets acquired	\$ 131,212

Included in the goodwill amount is \$16.8 million related to deferred tax liabilities recorded as a result of the inability to deduct intangible amortization expense associated with the acquisition of DHI. The Company's cost basis in the intangible assets is zero requiring an adjustment to the deferred tax liability to properly capture the Company's ongoing tax rate. The remainder of the goodwill balance reflects the complementary strategic fit that the acquisition of DHI brought to the Company.

The following table presents the preliminary results of the amounts assigned to the identifiable intangible assets acquired. The amount of intangible assets is subject to change and may result in a change to the fair value assigned to the intangible assets acquired and the related amortization periods as the review and evaluation is finalized. Intangible assets (except for in-process research and development) are amortized on a straight-line basis over the weighted-average amortization periods noted below for each type. In-process research and development is not amortized, but assessed at least annually for impairment, or more frequently when events or changes in circumstances indicate that the asset might be impaired.

(in thousands)	Fair value	Weighted-average amortization period (years)
Customer relationships	\$ 5,450	8.0
Purchased technology	46,570	9.0
Patents and trademarks	1,390	15.0
In-process research and development	2,110	N/A
Total	\$ 55,520	

The following unaudited pro forma financial information shows the combined results of operations of the Company, including DHI, as if the acquisition had occurred as of the beginning of the periods presented. The unaudited pro forma financial information is not intended to represent or be indicative of the Company's consolidated financial results of operations that would have been reported had the acquisition been completed as of the beginning of the periods presented and should not be taken as indicative of the Company's future consolidated results of operations.

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Note 2. Acquisition (Continued)

(in thousands, except per share data)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Pro forma total revenues	\$ 25,026	\$ 36,756	\$ 59,110	\$ 64,205
Pro forma net (loss) income	\$ (2,467)	\$ 1,221	\$ (7,702)	\$ (1,116)
Pro forma basic and diluted net (loss) earnings per share(1)	\$ (0.09)	\$ 0.04	\$ (0.27)	\$ (0.04)

(1) Included in the pro forma \$0.27 net loss per share for the six months ended June 30, 2010 is \$5.3 million of transactional expenses relating to the acquisition of DHI, which contributed \$0.11 to the pro forma net loss per share.

Note 3. Comprehensive (Loss) Income

Net (loss) income is equal to comprehensive (loss) income for both the three and six months ended June 30, 2010 and 2009, respectively.

Note 4. Computation of (Loss) Earnings Per Share

Basic (loss) earnings per share was computed by dividing net (loss) earnings by the weighted-average number of common shares outstanding, including vested restricted stock awards, during the period. Diluted earnings per share reflects the potential dilution that would occur if net earnings were divided by the weighted-average number of common shares and potentially dilutive common shares from outstanding stock options as well as unvested, time-based restricted stock awards. Potentially dilutive common shares were calculated using the treasury stock method and represent incremental shares issuable upon exercise of the Company's outstanding stock options and unvested, time-based restricted stock awards. The Company has awarded restricted stock with both time-based as well as performance-based vesting provisions. Stock awards based on only performance conditions are not included in the calculation of basic or diluted earnings per share until the performance criteria are met. For periods in which the Company incurs losses, potentially dilutive shares are not considered in the calculation of net loss per share, as their impact would be anti-dilutive. For periods in which the Company has earnings, out-of-the-money stock options (*i.e.*, the average stock price during the period is below the exercise price of the stock option) are not included in diluted

earnings per share as their effect would be anti-dilutive. For the three months ended June 30, 2009, 1.7 million shares were excluded from the calculation of diluted earnings per share as their effect was anti-dilutive.

The following table reconciles the weighted-average shares used in computing basic and diluted (loss) earnings per share in the respective periods (in thousands; unaudited):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Shares used in basic (loss) earnings per share (weighted-average common shares outstanding)	28,406	29,677	28,457	30,373
Effect of dilutive stock options and restricted stock awards		386		
Shares used in diluted (loss) earnings per share calculation	28,406	30,063	28,457	30,373

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Note 5. Inventories

Inventories are recorded at the lower of cost (first-in, first-out) or market and consist of the following (in thousands):

	June 30, 2010	December 31, 2009
Raw materials	\$ 7,808	\$ 5,307
Work-in-process (materials, labor and overhead)	4,866	3,711
Finished goods (materials, labor and overhead)	7,244	6,020
	\$ 19,918	\$ 15,038

Note 6. Other Current Liabilities

Other current liabilities consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Customer incentives	\$ 2,891	\$ 4,824
Stock repurchases not settled as of December 31, 2009		1,234
Accrued liability for technology license	750	
Accrued professional fees	240	345
Current portion of note payable to state agency	209	
Accrued interest on line of credit	178	
Other	616	824
	\$ 4,884	\$ 7,227

Note 7. Income Taxes

The Company's effective tax rate for the six months ended June 30, 2010 and 2009 was 59.1% and 39.0%, respectively. The Company recognized a tax benefit of \$7.2 million and \$1.4 million for the six months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010, the income tax benefit includes a charge related to the re-valuation of the Company's deferred tax assets due to a change in the statutory state tax rate. For the year ended December 31, 2010, the annual effective tax rate is impacted by; the deferred tax asset re-valuation discussed above; certain acquisition related non-deductible transaction costs; and the exclusion of the federal research and development tax credit.

The Company is subject to periodic audits by domestic and foreign tax authorities. The Company's federal tax years for 1995 and forward are subject to examination by the U.S. authorities due to the carry forward of unutilized net operating losses and research and development credits. With few exceptions, the Company's tax years for 1999 and forward are subject to examination by state and foreign tax authorities. The Company believes it has appropriate support for the income tax positions taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors, including past experience and interpretations of tax law applied to the facts of each matter.

Note 8. Line of Credit

The Company currently has a \$120.0 million senior secured syndicated credit facility (the Senior Credit Facility), which matures on October 8, 2013. The Senior Credit Facility bears interest at a rate ranging from 0.50% to 1.75% plus the lender s prime rate or, at the Company s option, a rate ranging from 1.50% to 2.75% plus the London InterBank Offering Rate. The agreement governing the Senior Credit Facility is subject to certain customary limitations, including among others: limitation on liens; limitation on mergers, consolidations and sales of assets; limitation on debt; limitation on

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Note 8. Line of Credit (Continued)

dividends, stock redemptions and the redemption and/or prepayment of other debt; limitation on investments (including loans and advances) and acquisitions; limitation on transactions with affiliates; and limitation on annual capital expenditures. The Company is also subject to financial covenants which include a funded debt to earnings before, among others, interest, taxes, depreciation and amortization (adjusted EBITDA, as defined in the Senior Credit Facility) ratio, and an interest coverage ratio. The Senior Credit Facility is secured by substantially all present and future assets and properties of the Company. As of June 30, 2010, the Company had \$45.0 million available under the Senior Credit Facility, which can fluctuate from time to time due to, among other factors, the Company's funded debt to adjusted EBITDA ratio. At June 30, 2010, the Company had \$75.0 million outstanding under the Senior Credit Facility which was borrowed in connection with the acquisition of DHI. At June 30, 2010, the Company was in compliance with all covenants.

During the first quarter of 2010, the Senior Credit Facility was amended for various matters, including amending the credit and security agreement to (i) permit the acquisition of all capital stock of DHI, (ii) allow certain indebtedness and liens related to the DHI acquisition to remain outstanding after the close of the acquisition and (iii) to amend the Senior Credit Facility to increase the aggregate amount of permitted stock repurchases thereunder.

Note 9. Stockholders' Equity

During the six months ended June 30, 2010, 161,903 shares of restricted stock were awarded, 79,559 shares of restricted stock were cancelled, 113,072 shares of common stock were issued due to the exercise of stock options and 12,530 shares of common stock were issued in connection with the Company's employee stock purchase plan (the ESPP), resulting in net proceeds to the Company of approximately \$0.9 million. Additionally, during the six months ended June 30, 2010, 740,177 shares of outstanding common stock were repurchased for approximately \$9.2 million, which primarily included shares repurchased under the Company's previously announced share repurchase program, but also included 27,677 shares repurchased in connection with payment of minimum tax withholding obligations for certain employees relating to the lapse of restrictions on certain restricted stock awards during the six months ended June 30, 2010.

Table of Contents

Quidel Corporation
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

Note 10. Stock-Based Compensation

The compensation expense related to the Company's stock-based compensation plans included in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009 was as follows (in millions):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	Cost of sales	\$ 0.2	\$ 0.1	\$ 0.3
Research and development	0.1	0.1	0.3	0.2
Sales and marketing	0.1	0.1	0.2	0.2
General and administrative	1.0	0.6	1.8	1.3
Restructuring charges				(0.2)
	\$ 1.4	\$ 0.9	\$ 2.6	\$ 1.7

Total compensation expense recognized for the three months ended June 30, 2010 and 2009 includes \$1.1 million and \$0.7 million related to stock options and \$0.3 million and \$0.2 million related to restricted stock, respectively. Total compensation expense recognized for the six months ended June 30, 2010 and 2009 includes \$2.0 million and \$1.3 million related to stock options and \$0.6 million and \$0.4 million related to restricted stock, respectively. As of June 30, 2010, total unrecognized compensation expense related to nonvested stock options was \$6.5 million, which is expected to be recognized over a weighted-average period of approximately 2.7 years. As of June 30, 2010, total unrecognized compensation expense related to nonvested restricted stock was \$2.2 million, which is expected to be recognized over a weighted-average period of approximately 2.9 years. Compensation expense capitalized to inventory and compensation expense related to the Company's ESPP were not material for the three and six months ended June 30, 2010 and 2009.

The estimated fair value of each stock option award was determined on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions for the option grants.

	Six months ended June 30,	
	2010	2009
Expected option life (in years)	4.89	4.65
Volatility rate	0.52	0.52
Risk-free interest rate	2.40%	