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BIOMET INC
Form 10-Q
October 02, 2003

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 August 31, 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
(State or other jurisdiction of
incorporation or organization)

35-1418342
(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 No

As of August 31, 2003, the registrant had 255,668,470 common shares outstanding.

BIOMET, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BIOMET, INC. AND SUBSIDIARIES

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

ASSETS

	August 31, 2003	May 31, 2003
	-----	-----
	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 221,711	\$ 225,650
Investments	16,826	37,337
Accounts and notes receivable, net	410,195	418,095
Inventories	361,216	356,270
Deferred income taxes	54,642	54,262
Prepaid expenses and other	24,699	20,141
	-----	-----
Total current assets	1,089,289	1,111,755
	-----	-----
Property, plant and equipment, at cost	478,105	468,965
Less, Accumulated depreciation	226,692	215,519
	-----	-----
Property, plant and equipment, net	251,413	253,446
	-----	-----
Investments	166,694	155,607
Goodwill, net	126,420	126,706
Intangible assets, net	10,551	10,874
Other assets	15,580	13,781
	-----	-----
Total assets	\$1,659,947	\$1,672,169
	=====	=====

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

BIOMET, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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at August 31, 2003 and May 31, 2003
(in thousands)

LIABILITIES AND SHAREHOLDERS' EQUITY

	August 31, 2003	May 31, 2003
	-----	-----
	(Unaudited)	
Current liabilities:		
Short-term borrowings	\$ 111,067	\$ 114,120
Accounts payable	37,933	42,106
Accrued income taxes	28,724	12,453
Accrued wages and commissions	38,255	43,715
Other accrued expenses	54,067	54,260
	-----	-----
Total current liabilities	270,046	266,654
Long-term liabilities:		
Deferred federal income taxes	6,193	7,031
Other liabilities	462	462
	-----	-----
Total liabilities	276,701	274,147
Minority interest	114,008	111,888
	-----	-----
Contingencies (Note 7)		
Shareholders' equity:		
Common shares	144,755	141,931
Additional paid-in capital	53,981	54,081
Retained earnings	1,078,243	1,100,462
Accumulated other comprehensive loss	(7,741)	(10,340)
	-----	-----
Total shareholders' equity	1,269,238	1,286,134
Total liabilities and shareholders' equity	\$1,659,947	\$1,672,169
	=====	=====

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

BIOMET, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

for the three months ended August 31, 2003 and 2002
(Unaudited, in thousands, except per share amounts)

	2003	2002
	----	----
Net sales	\$370,319	\$317,600
Cost of sales	105,618	90,137
	-----	-----
Gross profit	264,701	227,463
Selling, general and administrative expenses	132,397	115,888
Research and development expense	14,748	12,638
	-----	-----
Operating income	117,556	98,937

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Other income, net	3,021	3,944
	-----	-----
Income before income taxes and minority interest	120,577	102,881
Provision for income taxes	41,979	35,594
	-----	-----
Income before minority interest	78,598	67,287
Minority interest	2,120	1,281
	-----	-----
Net income	\$ 76,478	\$ 66,006
	=====	=====
Earnings per share:		
Basic	\$.30	\$.25
	=====	=====
Diluted	\$.30	\$.25
	=====	=====
Shares used in the computation of earnings per share:		
Basic	256,847	262,378
	=====	=====
Diluted	258,282	264,405
	=====	=====
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 three months ended August 31, 2003 and 2002
(Unaudited, in thousands)

	2003	2002
	----	----
Cash flows from (used in) operating activities:		
Net income	\$ 76,478	\$ 66,006
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	11,870	10,316
Amortization	754	1,025
Gain on sale of investments, net	(525)	(69)
Minority interest	2,120	1,281
Deferred income taxes	(470)	(699)
Changes in current assets and liabilities:		
Accounts and notes receivable, net	8,357	1,484
Inventories	(4,298)	(13,715)
Prepaid expenses and other	(4,781)	1,157
Accounts payable	(4,437)	6,168
Accrued income taxes	16,309	13,148
Accrued wages and commissions	(5,460)	(4,769)
Other accrued expenses	(482)	(5,176)
	-----	-----
Net cash from operating activities	95,435	76,157
	-----	-----
Cash flows from (used in) investing activities:		
Proceeds from sales and maturities of investments	59,010	46,211
Purchases of investments	(51,183)	(13,544)
Capital expenditures	(9,379)	(10,024)
Other	(1,029)	(2,533)
	-----	-----
Net cash from (used in) investing activities	(2,581)	20,110

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	-----	-----
Cash flows from (used in) financing activities:		
Increase (decrease) in short-term borrowings, net	(3,525)	2,313
Issuance of common shares	4,001	2,249
Cash dividends	(38,604)	(26,400)
Purchase of common shares	(61,720)	(106,000)
	-----	-----
Net cash used in financing activities	(99,848)	(127,838)
	-----	-----
Effect of exchange rate changes on cash	3,055	2,063
	-----	-----
Decrease in cash and cash equivalents	(3,939)	(29,508)
Cash and cash equivalents, beginning of year	225,650	154,297
	-----	-----
Cash and cash equivalents, end of period	\$221,711	\$124,789
	=====	=====

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 three-month period ended August 31, 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 three months ended August 31:

2003	2002
----	----
(in thousands)	

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Reconstructive	\$233,439	\$192,025
Fixation	62,133	59,381
Spinal products	37,967	33,266
Other	36,780	32,928
	-----	-----
	\$370,319	\$317,600
	=====	=====

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 three month periods ended August 31, 2003 and 2002 would have been as follows:

Net income as reported (in thousands)	\$76,478	\$66,006
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards net of related tax effects (in thousands)	1,282	1,382
	-----	-----
Pro forma net income (in thousands)	\$75,196	\$64,624
	=====	=====
Earnings per share:		
Basic, as reported	\$0.30	\$0.25
	=====	=====
Basic, pro forma	\$0.29	\$0.25
	=====	=====
Diluted, as reported	\$0.30	\$0.25
	=====	=====
Diluted, pro forma	\$0.29	\$0.24
	=====	=====

NOTE 2: COMPREHENSIVE INCOME.

Other comprehensive income includes foreign currency translation adjustments and unrealized appreciation (depreciation) of available-for-sale securities, net of taxes. Other comprehensive income for the three months ended August 31, 2003 and 2002 was \$2,599,000 and \$16,680,000, respectively. Total comprehensive income combines reported net income and other comprehensive income. Total comprehensive income for the three months ended August 31, 2003 and 2002 was \$79,077,000 and \$85,686,000, respectively.

NOTE 3: INVENTORIES.

Inventories at August 31, 2003 and May 31, 2003 are as follows:

	August 31,	May 31,
	2003	2003
	-----	-----
	(in thousands)	
Raw materials	\$ 37,488	\$ 37,685
Work-in-process	39,685	38,110
Finished goods	144,767	142,483
Consigned	139,276	137,992
	-----	-----
	\$361,216	\$356,270
	=====	=====

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NOTE 4: COMMON SHARES.

During the three months ended August 31, 2003, the Company issued 315,036 Common Shares upon the exercise of outstanding stock options for proceeds aggregating \$4,001,000. Purchases of Common Shares pursuant to the Common Share Repurchase Programs aggregated 2,135,249 shares for \$61,720,000 during the three months ended August 31, 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.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION AS OF AUGUST 31, 2003

The Company's cash and investments decreased \$13,363,000 to \$405,231,000 at August 31, 2003. This decrease resulted from the \$38,604,000 dividend paid during the first quarter and the \$61,720,000 used to purchase shares during the first three months pursuant to the share repurchase programs, offset by positive cash flow from operations.

Cash flows provided by operating activities were \$95,435,000 for the first three months of fiscal 2004 compared to \$76,157,000 in 2003. The primary sources of cash flows from operating activities in the first quarter were net income, depreciation, an increase in accrued income taxes and a reduction in accounts receivable. The primary uses were a reduction in accounts payable and accrued wages and commissions and an increase in inventory. Accrued income taxes increased during the quarter due to the first quarter tax estimates being due after the quarter end. Accounts payable decreased due to the lower levels of common stock being purchased at the end of this quarter versus last quarter, and accrued wages and commissions decreased because year end bonuses are paid during the first quarter. Inventory increases were caused by continued expansion in the Japanese market and new product introductions at 3i.

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Cash flows used in investing activities were \$2,581,000 for the first quarter of fiscal 2004 compared to cash flows provided of \$20,110,000 in 2003. The reason for the change year over year is due to the Company purchasing more investment during the current year versus last year. The primary source of cash flows from investing activities were sales and maturities of investments offset by purchases of investments and capital equipment.

Cash flows used in financing activities were \$99,848,000 for the first quarter of fiscal 2004 compared to a use of \$127,838,000 in 2003. The primary use of cash flows from financing activities was the cash dividend paid this 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 capital expenditures and research and development costs.

Pursuant to the terms of the Joint Venture Agreement with Merck KGaA ("Merck"), the Company granted Merck a put option whereby Merck has the right to elect to require the Company to purchase all, but not less than all, of Merck's interest in the BioMer C.V. ("BioMer"). Merck may exercise the put option by giving notice to the Company at any time during (a) the period beginning on May 1, 2001, and ending on May 10, 2008, or (b) a period of 180 days following receipt by Merck of notice from the Company that a "change of control" of the Company (as defined in the Joint Venture Agreement) has occurred prior to May 1, 2023. The put exercise price, which is payable in cash, is the greater of (i) a formula based on earnings of BioMer and multiples of comparative public companies, as defined in the Joint Venture Agreement, or (ii) the net book value of all the assets of BioMer less all liabilities of BioMer multiplied by Merck's 50% ownership percentage in BioMer. The put option formula is a mechanism whereby the Company would pay a fair market purchase price for Merck's 50% ownership interest in BioMer. If Merck chooses to exercise its put option in the future, at the time of exercise, the transaction could be deemed a material transaction for the Company; however, management believes that the transaction could be funded out of the Company's current operations and, given the Company's current cash position and the strength of its balance sheet, the transaction should not negatively impact the financial strength of the Company or its ongoing operations. As of the close of the Company's most recently completed fiscal quarter, the net book value purchase price of BioMer would be approximately \$112 million, which may or may not reflect the fair market purchase price at the time of closing the put transaction, should it occur.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED AUGUST 31, 2003 AS COMPARED TO THE THREE MONTHS ENDED AUGUST 31, 2002

Net sales increased 17% to \$370,319,000 for the first quarter of fiscal 2004 from \$317,600,000 for the same period last year. Excluding the impact of foreign currency which increased sales for the first quarter by \$15.4 million, net sales increased 12%. The Company's U.S.-based revenue increased 12% to \$252,095,000 during the first quarter of fiscal 2004, while foreign sales increased 27% to \$118,224,000. Excluding the positive foreign currency exchange, foreign sales in local currencies increased 11%. Biomet's worldwide sales of reconstructive products during the first quarter of fiscal 2004 were \$233,439,000, representing a 22% increase compared to last year. This increase came through balanced growth in all of the reconstructive product categories. Sales of fixation products were \$62,133,000 for the first quarter of fiscal 2004, representing a 5% increase as compared to the same period in 2003. The Company is experiencing a slowdown in its external fixation products from competitive minimally invasive internal fixation plating systems replacing external fixation products

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and reprocessors reconditioning its products. In addition, the Company has consolidated its domestic fixation business into its EBI subsidiary to allow one salesforce to distribute a full range of orthopedic fixation products. Sales of spinal products were \$37,967,000 for the first quarter of fiscal 2004, representing a 14% increase as compared to the same period in 2003. The increase is a result of continued market acceptance of EBI's spinal stimulation systems and the expansion of EBI's product portfolio in the hardware and biological segments of the spinal markets. The Company's sales of other products totaled \$36,780,000, representing a 12% increase over the first quarter of fiscal year 2003, primarily as a result of increased sales of arthroscopy products and softgoods and bracing products.

Cost of sales increased slightly as a percentage of net sales to 28.5% for the first quarter of fiscal 2004 from 28.4% for the same period last year. The increase in cost of sales as a percentage of net sales was primarily a result of higher growth rates in foreign sales, where gross margins are lower, versus domestic sales. In local currencies, the Company continues to see improvement in this percentage. Selling, general and administrative expenses as a percentage of net sales decreased to 35.7% compared to 36.5% for the first quarter of 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 17% during the quarter to \$14,748,000 reflecting the Company's continued emphasis on new product introductions. Operating income rose 19% from \$98,937,000 for the first quarter of fiscal 2003 to \$117,556,000 for the first quarter of fiscal 2004. Other income decreased 23% to \$3,021,000 compared to last year. Over the last seven quarters, the Company has used \$491,000,000 to purchase its common stock which has reduced investable cash. 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 quarter of fiscal year 2004 from 34.6% last year primarily as a result of states increasing their tax rates.

These factors resulted in a 16% increase in net income to \$76,478,000 for the first quarter of fiscal 2004 as compared to \$66,006,000 for the same period in fiscal 2003. Basic and diluted earnings per share increased 20%, from \$.25 to \$.30 for the periods presented.

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 first 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

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reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders.

The Annual Meeting of Shareholders of the Company was held on September 27, 2003. At the Annual Meeting:

- 1. The following persons were elected as Directors of the Company for a three-year term expiring in 2006.

Table with 3 columns: Name, Votes For, Votes Withheld. Rows include Dane A. Miller, Ph. D., Jerry L. Ferguson, Thomas F. Kearns, Jr., and Daniel P. Hann.

The following directors will continue in office until their term expires at the 2004 Annual meeting of shareholders: M. Ray Harroff; Jerry L. Miller and Charles E. Niemier.

The following directors will continue in office until their term expires at the 2005 Annual meeting of shareholders: C. Scott Harrison, M.D.; Niles L. Noblitt; Kenneth V. Miller; L. Gene Tanner; and Marilyn Tucker Quayle.

- 2. The selection of Ernst & Young LLP as certified public accountants for the Company for the fiscal year ending May 31, 2004 was ratified by the shareholders, as follows: Votes For - 218,973,641; Votes Against - 4,758,329; and Abstentions and Broker Non-Votes - 1,251,004.

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.
(Registrant)

DATE: 10/02/2003

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.

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INDEX TO EXHIBITS

Number Assigned
in Regulation S-K
Item 601

Description of Exhibit

Number Assigned in Regulation S-K Item 601	Description 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 2, 1989. (Incorporated by reference to Exhibit 4 to Biomet, Inc. Form 8-K Current Report dated December 22, 1989, File No. 0-12515), as amended September 1, 2002 to change rights agent to American Stock Transfer 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 Executive 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.