MENTOR CORP /MN/
Form 10-Q
November 08, 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 September 30, 2004

or

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

For the transition period from ____ to _____

Commission File No. 0-7955

**MENTOR CORPORATION**
(Exact Name of Registrant as Specified in its Charter)

| | | | |
|---|---|---|---|
| | Minnesota | 41-0950791 | |
| | (State or other jurisdiction of | (IRS Employer Identification No.) | |
| | incorporation or organization) | | |

201 Mentor Drive, Santa Barbara, California 93111
(Address of Principal Executive Offices) (Zip Code)
Registrant's telephone number including area code: 805/879-6000

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 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 o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No o

As of November 5, 2004 there were approximately 42,796,358 Common Shares, par value $.10, outstanding.

**MENTOR CORPORATION**

**INDEX**

**PART I - FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

Mentor Corporation
Consolidated Balance Sheets
(Unaudited)

| (in thousands) | **September 30, 2004** | March 31, 2004 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 127,189** | $ 118,225 |
| Marketable securities | **458** | 193 |
| Accounts receivable, net | **102,967** | 106,016 |
| Inventories | **73,449** | 67,912 |
| Deferred income taxes | **23,838** | 22,488 |
| Prepaid expenses and other | **16,750** | 13,205 |
| Total current assets | **344,651** | 328,039 |
| | | |
| Property and equipment, net | **74,641** | 77,529 |
| Intangible assets, net | **48,320** | 51,014 |
| Goodwill, net | **23,820** | 23,711 |
| Long-term marketable securities and investments | **35,194** | 8,326 |
| Other assets | **10,169** | 10,160 |
| | **$ 536,795** | $ 498,779 |

See notes to condensed consolidated financial statements.

Mentor Corporation
Consolidated Balance Sheets
(Unaudited)

| (in thousands) | **September 30, 2004** | March 31, 2004 |
|---|---|---|
| **Liabilities and shareholders' equity** | | |
| Current liabilities: | | |
| Accounts payable | **$ 32,429** | $ 37,126 |
| Warranty and related reserves | **24,572** | 23,396 |
| Accrued compensation | **19,547** | 18,212 |
| Short-term bank borrowings | **9,385** | 10,012 |
| Sales returns | **11,536** | 11,797 |
| Deferred revenue | **11,654** | 6,915 |
| Income taxes payable | **-** | 285 |
| Current portion of purchase price related to acquired technologies and acquisitions | **1,775** | 1,864 |
| Interest payable | **1,021** | 1,187 |
| Dividends payable | **7,260** | 6,309 |
| Accrued royalties | **708** | 567 |
| Other | **14,921** | 12,260 |
| Total current liabilities | **134,808** | 129,930 |
| | | |
| Deferred income taxes | **2,569** | 2,549 |
| Deferred revenue | **1,977** | - |
| Long-term accrued liabilities | **18,178** | 17,996 |
| Convertible subordinated notes | **150,000** | 150,000 |
| | | |
| Shareholders' equity: | | |
| Common Stock, $.10 par value: | | |
| Authorized - 150,000,000 shares; Issued and outstanding 42,784,558 shares at September 30, 2004; 42,059,136 shares at March 31, 2004; | **4,278** | 4,206 |
| Capital in excess of par value | **12,780** | - |
| Accumulated other comprehensive income | **20,649** | 19,122 |
| Retained earnings | **191,556** | 174,976 |
| | **229,263** | 198,304 |
| | **$ 536,795** | $ 498,779 |

See notes to condensed consolidated financial statements.

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Mentor Corporation
Consolidated Statements of Income
Three Months Ended September 30, 2004 and 2003
(Unaudited)

| (in thousands, except per share data) | Three Months Ended September 30, **2004** | 2003 |
|---|---|---|
| Net sales | **$ 108,779** | $ 93,263 |
| Cost of sales | **40,638** | 35,561 |
| Gross profit | **68,141** | 57,702 |
| Selling, general and administrative expense | **40,568** | 33,899 |
| Research and development expense | **8,553** | 7,711 |
| | **49,121** | 41,610 |
| Operating income | **19,020** | 16,092 |
| Interest expense | **(1,228)** | (149) |
| Interest income | **533** | 323 |
| Other income, net | **5** | 249 |
| Income before income taxes | **18,330** | 16,515 |
| Income taxes | **5,796** | 5,277 |
| Net income | **$ 12,534** | $ 11,238 |
| Basic earnings per share | **$ 0.29** | $ 0.24 |
| Diluted earnings per share | **$ 0.28** | $ 0.23 |
| Dividends per share | **$ 0.17** | $ 0.15 |
| Weighted average shares outstanding | | |
| Basic | **42,548** | 46,562 |
| Diluted | **45,238** | 48,610 |

See notes to condensed consolidated financial statements.

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Mentor Corporation
Consolidated Statements of Income
Six Months Ended September 30, 2004 and 2003
(Unaudited)

| (in thousands, except per share data) | Six Months Ended September 30, **2004** | 2003 |
|---|---|---|
| Net sales | **$ 231,211** | $ 198,369 |
| Cost of sales | **84,613** | 74,934 |
| Gross profit | **146,598** | 123,435 |
| Selling, general and administrative expense | **83,820** | 69,578 |
| Research and development expense | **16,583** | 15,254 |
| | **100,403** | 84,832 |
| Operating income | **46,195** | 38,603 |
| Interest expense | **(2,636)** | (310) |
| Interest income | **948** | 719 |
| Other income (expense), net | **(183)** | 925 |
| Income before income taxes | **44,324** | 39,937 |
| Income taxes | **14,136** | 12,666 |
| Net income | **$ 30,188** | $ 27,271 |
| Basic earnings per share | **$ 0.71** | $ 0.59 |
| Diluted earnings per share | **$ 0.67** | $ 0.56 |
| Dividends per share | **$ 0.32** | $ 0.17 |
| Weighted average shares outstanding | | |
| Basic | **42,356** | 46,475 |
| Diluted | **45,138** | 48,479 |

See notes to condensed consolidated financial statements.

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Mentor Corporation
Consolidated Statements of Cash Flows
Six Months Ended September 30, 2004 and 2003
(Unaudited)

| (in thousands) | **2004** | 2003 |
|---|---|---|
| **Operating Activities:** | | |
| Net income | **$ 30,188** | $ 27,271 |
| Adjustments to derive cash flows from operating activities: | | |
| Depreciation | **7,289** | 6,453 |
| Amortization | **2,368** | 1,658 |
| Deferred income taxes | **(1,631)** | (2,131) |
| Tax benefit from exercise of stock options | **3,223** | 2,778 |
| (Gain) loss on sale of assets | **1,436** | (302) |
| Imputed interest on long-term liabilities | **15** | 139 |
| (Gain) loss on long-term marketable securities | **-** | 136 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | **3,918** | 3,164 |
| Inventories | **(4,836)** | (3,754) |
| Prepaid income taxes and other current assets | **(3,533)** | (8,096) |
| Accounts payable and accrued liabilities | **7,364** | (326) |
| Income taxes payable | **(267)** | (439) |
| Net cash provided by operating activities | **45,534** | 26,551 |
| **Investing Activities:** | | |
| Purchases of property and equipment | **(4,829)** | (9,089) |
| Purchases of intangibles | **(1,500)** | (4,673) |
| Purchases of marketable securities | **(69,028)** | (28,244) |
| Sales of marketable securities | **41,854** | 21,466 |
| Acquisitions, net of cash acquired | **-** | (7,192) |
| Net cash used for investing activities | **(33,503)** | (27,732) |
| **Financing Activities:** | | |
| Repurchase of common stock | **-** | (8,601) |
| Proceeds from exercise of stock options | **9,628** | 6,602 |
| Dividends paid | **(13,637)** | (1,858) |
| Borrowings (repayments) under line of credit agreements, net | **632** | (128) |
| Net cash used for financing activities | **(3,377)** | (3,985) |
| Effect of currency exchange rates on cash and cash equivalents | **310** | 370 |
| Increase (decrease) in cash and cash equivalents | **8,964** | (4,796) |
| Cash and cash equivalents at beginning of year | **118,225** | 105,840 |
| Cash and cash equivalents at end of period | **$ 127,189** | $ 101,044 |

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**MENTOR CORPORATION**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**September 30, 2004**

**Note A - Business Activity**

Mentor Corporation (the "Company") was incorporated in April 1969. Unless the context indicates otherwise, when we refer to "Mentor," "we," "us," "our," or the "Company" in this Form 10-Q, we are referring to Mentor Corporation and its subsidiaries on a consolidated basis. We develop, manufacture and market a broad range of products serving the medical specialties market. Our products are utilized by three primary segments, aesthetic and general surgery (plastic and reconstructive surgery), surgical urology, and clinical and consumer healthcare. Aesthetic and general surgery products include surgically implantable prostheses for plastic and reconstructive surgery as well as capital equipment and consumables used for soft tissue aspiration or body contouring (liposuction). Surgical urology products include surgically implantable prostheses for the treatment of impotence, surgically implantable incontinence products, urinary care products and brachytherapy seeds for the treatment of prostate cancer. Clinical and consumer healthcare products include catheters and other products for the management of urinary incontinence and retention.

**Note B - Summary of Significant Accounting Policies**

The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained. For those subsidiaries where the Company owns less than 100%, the outside shareholders' interests are treated as minority interests. All inter-company accounts and transactions have been eliminated. Certain prior year amounts in previously issued financial statements have been reclassified to conform to the current year presentation.

**Basis of Presentation**

The financial information for the three and six months ended September 30, 2004 and 2003 is unaudited but includes all adjustments (consisting only of normally recurring accruals, unless otherwise indicated) that the Company considers necessary for a fair presentation of the results of operations for these periods. Interim results are not necessarily indicative of results for the full fiscal year.

**Use of Estimates**

Financial statements prepared in accordance with accounting principles generally accepted in the United States require management to make estimates and judgments that affect amounts and disclosures reported in the financial statements. Actual results could differ from those estimates. A discussion of the Company's significant accounting policies is described in the "Application of Critical Accounting Policies" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Effects of Recent Accounting Pronouncements**

In July 2004, the Financial Accounting Standards Board (FASB) released draft abstract Emerging Issue Task Force (EITF) Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share," for comment. The objective of this Issue is to provide guidance for whether contingently convertible debt instruments should be included in diluted earnings per share calculations. The draft abstract reflects the Task Force's tentative conclusion that contingently convertible debt should be included in diluted earnings per share calculations regardless of whether or not the trigger price has been reached. In its September meeting, the Task Force confirmed the July conclusion, and the guidance becomes effective December 15, 2004. The impact of the Issue will be to change the diluted earnings per share calculation by increasing net income used in the numerator by the after tax amount of interest expense related to the convertible notes (approximately $800,000 for the quarter), and increasing weighted average shares outstanding used in the denominator by 5.1 million shares; the number of shares to be issued upon full conversion of the convertible notes. The effect would decrease diluted earnings per share by $.02 cents per share for the quarter ended September 30, 2004. We expect to adopt the guidance in the quarter ended December 31, 2004.

In March 2004, the Financial Accounting Standards Board (FASB) approved the consensus reached on the EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. The accounting provisions of EITF 03-1 are effective for all reporting periods beginning after June 15, 2004, while the disclosure requirements are effective only for annual periods ending after June 15, 2004. We have evaluated the impact of the adoption of EITF 03-1 and do not believe it will be significant to our results of operations or financial position.

**Note C - Interim Reporting**

The Company's three quarterly interim reporting periods are each thirteen-week periods ending on the Friday nearest the end of the third calendar month of each calendar quarter. The fiscal year end remains March 31st. To facilitate ease of presentation, each interim period is shown as if it ended on the last day of the appropriate calendar month. The actual dates for each of the three interim quarters-end are shown below:

| | Fiscal 2005 | Fiscal 2004 |
|---|---|---|
| First Quarter | July 2, 2004 | June 27, 2003 |
| Second Quarter | October 1, 2004 | September 26, 2003 |
| Third Quarter | December 31, 2004 | January 2, 2004 |

The accompanying unaudited condensed consolidated financial statements for the three month and six month periods ended September 30, 2004 and 2003 have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with 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 United States for complete financial statements. In the opinion of management, all adjustments (consisting only of normally recurring accruals, unless otherwise indicated) considered necessary for a fair presentation of the results of operations for the indicated periods have been included. Certain amounts recorded in previous periods have been reclassified to conform to the current period presentation. Operating results for the three month and six month periods ended September 30, 2004 are not necessarily indicative of the results for the full fiscal year.

The balance sheet at March 31, 2004 has been derived from the audited financial statements as of that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended March 31, 2004.

**Note D - Cash Equivalents, Marketable Securities, and Long-Term Marketable Securities and Investments**

All highly liquid investments with maturities of three months or less at the date of purchase are considered to be cash equivalents.

The Company considers its marketable securities available-for-sale as defined in Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Realized gains and losses, and declines in value considered to be other than temporary, are included in income. The cost of securities sold is based on the specific identification method. For short-term marketable securities, there were no material realized or unrealized gains or losses, nor were there any material differences between estimated fair values, based on quoted market prices, and the costs of securities in the investment portfolio as of September 30, 2004, and March 31, 2004. Short-term investments, except auction rate securities, mature between three months and one year from the purchase date. The Company's short-term marketable securities consist primarily of money market mutual funds, U.S. state and municipal government and government agency obligations, auction rate securities, and investment grade corporate obligations including commercial paper. Auction rate securities carry interest or dividend rates that reset every 28 days but have contractual maturities of greater than one year.

The Company's long-term marketable securities and investments include investments in Federal Home Loan Bank and Mortgage Association bonds (FHLA bonds) with maturities of two to four years.

**Available-for-sale investments at September 30, 2004 were as follows**:

| (in thousands) | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| **Cash balances** | **$ 38,333** | **$ -** | **$ -** | **$ 38,333** |
| **Money market mutual funds** | **88,856** | **-** | **-** | **88,856** |
| **Marketable equity securities** | **144** | **-** | **(8)** | **136** |
| **U.S., state and municipal agency obligations** | **35,305** | | **(67)** | **35,238** |
| **Corporate debt securities** | **278** | **-** | **-** | **278** |
| **Total available-for-sale investments** | **$ 162,916** | **-** | **$ (75)** | **$ 162,841** |
| | | | | |
| **Included in cash and cash equivalents** | **127,189** | **-** | **-** | **127,189** |
| **Included in current marketable securities** | **458** | **-** | **-** | **458** |
| **Included in long-term marketable securities and investments** | **35,269** | **-** | **(75)** | **35,194** |
| **Total available-for-sale investments** | **$ 162,916** | **$ -** | **$ (75)** | **$ 162,841** |

Available-for-sale investments at March 31, 2004 were as follows:

| (in thousands) | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Cash balances | $ 19,139 | $ - | $ - | $ 19,139 |
| Bank time deposits | - | - | - | - |
| Money market mutual funds | 99,086 | - | - | 99,086 |
| Marketable equity securities | 56 | - | (8) | 48 |
| U.S., State and Municipal agency obligations | 8,193 | - | - | 8,193 |
| Corporate debt securities | 278 | - | - | 278 |
| Total available-for-sale investments | $ 126,752 | - | (8) | $ 126,744 |
| | | | | |
| Included in cash and cash equivalents | 118,225 | - | - | 118,225 |
| Included in current marketable securities | 193 | - | - | 193 |
| Included in long-term marketable securities and investments | 8,334 | - | (8) | 8,326 |
| Total available-for-sale investments | $ 126,752 | $ - | $ (8) | $ 126,744 |

**Note E - Inventories**

Inventories are stated at the lower of cost or market, cost determined by the first-in, first-out (FIFO) method. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions.

Inventories at September 30, 2004 and March 31, 2004 consisted of:

| (in thousands) | **September 30,** | March 31 |
|---|---|---|
| Raw materials | **$ 14,209** | $ 13,050 |
| Work in process | **12,587** | 11,572 |
| Finished goods | **46,653** | 43,290 |
| | **$ 73,449** | $ 67,912 |

**Note F - Property and Equipment**

Property and equipment is stated at cost. Depreciation is based on the useful lives of the properties and computed using the straight-line method. Buildings are depreciated over 30 years, furniture and equipment over 3 to 10 years and leasehold improvements over the shorter of their estimated remaining lives or lease terms. Significant improvements and betterments are capitalized while maintenance and repairs are charged to operations as incurred.

Property and equipment at September 30, 2004 and March 31, 2004 consisted of:

| (in thousands) | **September 30,** | March 31, |
|---|---|---|
| Land | **$ 566** | $ 561 |
| Buildings | **24,883** | 24,534 |
| Leasehold improvements | **24,849** | 23,776 |
| Furniture, fixtures and equipment | **106,196** | 103,242 |
| Construction in progress | **3,662** | 3,811 |
| | **160,156** | 155,924 |
| Less accumulated depreciation | **(85,515)** | (78,395) |
| | **$ 74,641** | $ 77,529 |

**Note G - Warranties**

The Company provides an accrual for the estimated cost of product warranties and product liability claims at the time revenue is recognized. Such accruals are based on estimates, which are based on relevant factors such as historical experience, the warranty period, estimated costs, levels of insurance and insurance retentions, identified product quality issues, if any, and to a limited extent, information developed by the insurance company using actuarial techniques. The Company assesses the adequacy of these accruals periodically and adjusts the amounts as necessary based on actual experience and changes in future expectations.

Information on changes in the Company's accrued warranties and related reserves are as follows:

| | Six Months Ended September 30, | |
|---|---|---|
| (in thousands) | **2004** | 2003 |
| Beginning warranty and related reserve | **$ 23,396** | $ 19,989 |
| Costs of warranty claims | **(2,122)** | (1,930) |
| Accruals for product warranties | **3,298** | 4,063 |
| Ending warranty and related reserves | **$ 24,572** | $ 22,122 |

**Note H - Other Comprehensive Income**

The components of comprehensive income are listed below:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | **2004** | 2003 | **2004** | 2003 |
| Net income | **$ 12,534** | $ 11,238 | **$ 30,188** | $ 27,271 |
| Foreign currency translation adjustment | **1,613** | 826 | **1,571** | 5,858 |
| Unrealized (losses) on marketable securities and investment activities, net | **117** | 25 | **(44)** | 146 |
| Comprehensive income | **$ 14,264** | $ 12,089 | **$ 31,715** | $ 33,275 |

**Note I - Stock Options**

The Company has granted options to key employees and non-employee directors under its Amended 2000 Long-Term Incentive Plan (2000 Plan) and 1991 Plan. Options granted under both plans are exercisable in four equal annual installments beginning one year from the date of grant, and expire ten years from the date of grant. Options are granted at the fair market value as of the date of grant. Options to purchase 732,750 shares of common stock at $32.23 per share were granted during the quarter ended June 30, 2004. Options to purchase 47,500 shares of common stock at $34.58 per share were granted during the quarter ended September 30, 2004.

Stock option exercise prices are set at the fair market value of the Company's common stock on the date of grant and the related number of shares granted is fixed at that point in time. Therefore, under the principles of Accounting Principles Board (APB) Opinion 25, the Company does not recognize compensation expense associated with the grant of stock options. SFAS 123 "Accounting for Stock-Based Compensation", requires the use of an option valuation model to provide supplemental information regarding options granted after fiscal 1995. Pro forma information regarding net income and earnings per share shown below were determined as if the Company had accounted for its employee stock options under the fair value method of that statement. The estimated fair value of the options is amortized ratably over the options' vesting period. As required by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123", the following table shows the estimated effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS 123 to stock-based employee compensation. The Company's pro forma information is as follows:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands except per share data) | **2004** | 2003 | **2004** | 2003 |
| Net income: as reported [1] | **$ 12,534** | $ 11,238 | **$ 30,188** | $ 27,271 |
| Deduct: compensation expense fair value method | **(1,787)** | (1,899) | **(3,555)** | (3,319) |
| Net income: pro forma | **$ 10,747** | $ 9,339 | **$ 26,633** | $ 23,952 |
| Basic earnings per share: as reported | **$ .29** | $ .24 | **$ .71** | $ .59 |
| Basic earnings per share: pro forma | **$ .25** | $ .20 | **$ .63** | $ .51 |
| Diluted earnings per share: as reported | **$ .28** | $ .23 | **$ .67** | $ .56 |
| Diluted earnings per share: pro forma | **$ .24** | $ .20 | **$ .59** | $ .50 |

[1] Net income as reported includes no compensation expense associated with stock grants.

**Note J - Income Taxes**

The effective rate of corporate income taxes was 31.9% and 31.7% for the six-month periods ended September 30, 2004 and 2003, respectively.

**Note K - Earnings per Share**

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of shares of the Company's common shares outstanding during the period. Diluted earnings per share is calculated in the same manner as basic earnings per share except that the number of shares outstanding is increased by potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of shares issuable under the terms of employee stock options, warrants, and the 2¾% convertible subordinated notes. A reconciliation of weighted average shares outstanding, used to calculate basic earnings per share, to weighted average shares outstanding assuming dilution, used to calculate diluted earnings per share, follows:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | **2004** | 2003 | **2004** | 2003 |
| Weighted average outstanding shares: basic | **42,548** | 46,562 | **42,356** | 46,475 |
| Shares issuable through exercise of stock options | **2,690** | 2,048 | **2,782** | 2,004 |
| Weighted average outstanding shares: diluted | **45,238** | 48,610 | **45,138** | 48,479 |

Shares issuable through stock options are determined using the treasury stock method. Certain potential shares issuable under the terms of employee stock options were excluded from the computation of diluted earnings per share since their exercise prices were greater than the market prices of the common shares during or at the end of the period, and accordingly, their effect would have been anti-dilutive. Shares potentially issuable upon the conversion of the 2¾% convertible subordinated notes were excluded as the market prices of the common shares did not reach the specific levels for the specified times required in order for the notes to allow conversion during the period. Additionally, during the quarter ended September 30, 2004, the price of the Company's stock did not exceed the specific strike prices of the convertible bond hedge or the warrants for the specified time required that the Company entered into to reduce the potential dilution from any conversion of the notes. Both the bond hedge and the warrants transaction may be settled at the Company's option, either in cash or shares, and expire on January 1, 2009.

**Note L - Share Repurchase Program**

The Company has a stock repurchase program, primarily to offset the dilutive effect of our employee stock option program, to provide liquidity to the market and to reduce the overall number of shares outstanding. All shares repurchased under the program are retired and are no longer deemed to be outstanding. In May 1999, the Board of Directors authorized the repurchase of 9.2 million shares of our stock. Each year shares have been repurchased including 1.4 million shares for $22.3 million and 1.5 million shares for $18.7 million in the years ended March 31, 2003 and 2002, respectively. At March 31, 2003, 1.8 million shares were remaining under this authorization. On July 31, 2003 the Board of Directors increased the authorized number of shares to be repurchased from 1.8 million to 4 million shares. On December 5, 2003, the Board of Directors increased the authorized number of shares to be repurchased by 5 million shares from 2.5 million to 7.5 million shares. During fiscal 2004, 5.4 million shares were repurchased for $135.8 million and 3.6 million shares remained authorized for repurchase as of March 31, 2004 and September 30, 2004. The timing of repurchases is subject to market conditions, cash availability, and blackout periods during which the Company is restricted from repurchasing shares. There is no guarantee that shares authorized for repurchase by the Board will ultimately be repurchased. There were no share repurchases during the three-month and six-month periods ending September 30, 2004.

**Note M - Acquisitions**

**South Bay Medical LLC**

On January 19, 2001, the Company purchased the assets of South Bay Medical LLC (South Bay), a company focused on the development of a new computer-based workstation and automated cartridge-based needle loading system for use in brachytherapy procedures. The acquisition was accounted for as a purchase with the results of operations included in the Company's financial statements from the date of acquisition. The Company paid $2 million in cash and issued restricted common stock valued at $4 million on the date of purchase. Additional purchase price payments will be made to South Bay over the next several years as workstation sales are made. The net present value of these amounts is recorded at September 30, 2004, in current accrued liabilities ($775,000) and in long-term accrued liabilities ($10,550,000) as the Company believes it is probable these payments will be paid.

**Prosurg, Inc.**

In December 2001, the Company entered into several agreements with Prosurg, Inc., to acquire certain patent rights and obtain a source of supply of a bio-absorbable co-polymer for $2 million in cash and up to an additional $2 million upon the achievement of certain milestones. The purchase price was allocated to intangible assets and the net present value of these amounts is recorded at September 30, 2004, in accrued liabilities ($1,000,000) and in long-term accrued liabilities ($1,000,000) as the Company believes it is probable these payments will be paid.

**A-Life Ltd.**

On August 25, 2003, the Company completed the acquisition of A-Life Ltd, which has developed a hyaluronic acid based dermal filler product, from Vitrolife, AB. The acquisition was valued at $7.5 million; net of cash acquired, and was paid from existing cash balances. The purchase price was allocated to the tangible and intangible net assets acquired on the basis of their respective fair values on the acquisition date. The purchase price was preliminarily allocated to accounts receivable of $36,000, other assets of $349,000, production equipment of $393,000 and intangible assets of $6,821,000, net of accrued liabilities of $123,000.

**Note N - Goodwill & Intangible Assets**

In 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 was effective for the Company as of April 1, 2002. SFAS No. 142 specifies the financial accounting and reporting for acquired goodwill and other intangible assets. Goodwill and intangible assets that have indefinite useful lives are no longer to be amortized, but rather are to be tested for impairment annually or more frequently if impairment indicators arise. None of the Company's intangible assets have an indefinite life. Intangible assets with finite lives continue to be amortized over their useful lives ranging from 3-20 years on a straight line basis. Goodwill and intangible assets have been recorded at either incurred or allocated cost. Allocated costs were based on respective fair values at the date of acquisition.

Upon the adoption of SFAS No. 142, the Company reassessed the remaining amortization periods of intangible assets acquired on or before June 30, 2001, and assigned all goodwill to reporting units for impairment testing. The impairment tests involve the use of both estimates of fair value for the Company's reporting units as well as discounted cash flow assumptions. Impairment tests were performed at adoption and in the fourth quarter of fiscal years 2004 and 2003 and no impairment was noted as a result of these analyses.

As of September 30, 2004 and March 31, 2004, accumulated amortization of intangible assets was $16.6 million and $14.2 million respectively.

**Note O - Long-term Debt**

On December 22, 2003, the Company completed an offering of $150 million of convertible subordinated notes due January 1, 2024 pursuant to Rule 144A under the Securities Act of 1933. The notes bear interest at 2¾% per annum and are convertible into shares of the Company's common stock at a conversion price of $29.27 per share and are subordinated to all existing and future senior debt.

Holders of the notes may convert their notes only if any of the following conditions is satisfied:

- during any fiscal quarter prior to January 1, 2019, if the closing price of the Company's common stock for at least 20 trading days