

CHARLES RIVER LABORATORIES INTERNATIONAL INC
Form 10-Q
November 02, 2016
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 SEPTEMBER 24, 2016

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 No. 001-15943

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware 06-1397316

(State or Other Jurisdiction of (I.R.S. Employer

Incorporation or Organization) Identification No.)

251 Ballardvale Street 01887

Wilmington, Massachusetts (Zip Code)
(Address of Principal Executive Offices)

(Registrant's telephone number, including area code): (781) 222-6000

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 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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes 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.

Non-accelerated filer

Large accelerated filer Accelerated filer (Do not check if smaller reporting company)
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 October 17, 2016, there were 47,328,587 shares of the Registrant's common stock outstanding.

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 24, 2016

TABLE OF CONTENTS

Item	Page
PART I - FINANCIAL INFORMATION	
1	Financial Statements
	Condensed Consolidated Statements of Income (Unaudited) for the three and nine months ended September 24, 2016 and September 26, 2015
	Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the three and nine months ended September 24, 2016 and September 26, 2015
	Condensed Consolidated Balance Sheets (Unaudited) as of September 24, 2016 and December 26, 2015
	Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 24, 2016 and September 26, 2015
	Notes to Unaudited Condensed Consolidated Financial Statements
2	Management's Discussion and Analysis of Financial Condition and Results of Operations
3	Quantitative and Qualitative Disclosure About Market Risk
4	Controls and Procedures
PART II - OTHER INFORMATION	
1	Legal Proceedings
1A	Risk Factors
2	Unregistered Sales of Equity Securities and Use of Proceeds
6	Exhibits
	Signatures

Special Note on Factors Affecting Future Results

This Quarterly Report on Form 10-Q contains forward-looking statements regarding future events and the future results of Charles River Laboratories International, Inc. that are based on our current expectations, estimates, forecasts and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as “expect,” “anticipate,” “target,” “goal,” “project,” “intend,” “plan,” “believe,” “seek,” “estimate,” “will,” “likely,” “may,” “future,” “can,” “could” and other similar expressions that are predictions of or indicate future events and trends or which do not relate to historical matters are intended to identify such forward-looking statements. These statements are based on our current expectations and beliefs and involve a number of risks, uncertainties and assumptions that are difficult to predict. For example, we may use forward-looking statements when addressing topics such as: goodwill and asset impairments still under review; future demand for drug discovery and development products and services, including the outsourcing of these services; our expectations regarding stock repurchases, including the number of shares to be repurchased, expected timing and duration, the amount of capital that may be expended and the treatment of repurchased shares; present spending trends and other cost reduction activities by our clients; future actions by our management; the outcome of contingencies; changes in our business strategy, business practices and methods of generating revenue; the development and performance of our services and products; market and industry conditions, including competitive and pricing trends; our strategic relationships with leading pharmaceutical companies and venture capital investments and opportunities for future similar arrangements; our cost structure; the impact of acquisitions including Sunrise, Celsis, Oncotest, WIL Research, Blue Stream and Agilux; our expectations with respect to revenue growth and operating synergies (including the impact of specific actions intended to cause related improvements); the impact of specific actions intended to improve overall operating efficiencies and profitability (and our ability to accommodate future demand with our infrastructure), including gains and losses attributable to businesses we plan to close, consolidate or divest; changes in our expectations regarding future stock option, restricted stock, performance share units and other equity grants to employees and directors; expectations with respect to foreign currency exchange; assessing (or changing our assessment of) our tax positions for financial statement purposes; and our liquidity. In addition, these statements include the impact of economic and market conditions on us and our clients, including the potential impact of Brexit; the effects of our cost saving actions and the steps to optimize returns to shareholders on an effective and timely basis and our ability to withstand the current market conditions. You should not rely on forward-looking statements because they are predictions and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or in the case of statements incorporated by reference, on the date of the document incorporated by reference. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in our Annual Report on Form 10-K for the year ended December 26, 2015 under the sections entitled “Our Strategy,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in our press releases and other financial filings with the Securities and Exchange Commission. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks. New information, future events or risks may cause the forward-looking events we discuss in this report not to occur.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 26, 2016	September 26, 2015	September 26, 2016	September 26, 2015
Service revenue	\$292,849	\$ 222,506	\$806,397	\$ 633,666
Product revenue	132,871	126,959	408,246	375,786
Total revenue	425,720	349,465	1,214,643	1,009,452
Costs and expenses:				
Cost of services provided (excluding amortization of intangible assets)	200,118	145,165	543,588	425,614
Cost of products sold (excluding amortization of intangible assets)	69,332	66,225	204,270	193,320
Selling, general and administrative	85,650	76,225	269,067	218,953
Amortization of intangible assets	11,825	6,410	29,390	17,385
Operating income	58,795	55,440	168,328	154,180
Other income (expense):				
Interest income	523	177	1,008	758
Interest expense	(7,079)	(3,851)	(20,199)	(11,251)
Other income (expense), net	1,017	1,390	10,059	1,749
Income from continuing operations, before income taxes	53,256	53,156	159,196	145,436
Provision for income taxes	15,565	15,255	48,385	26,662
Income from continuing operations, net of income taxes	37,691	37,901	110,811	118,774
Income (loss) from discontinued operations, net of income taxes	342	(34)	328	(48)
Net income	38,033	37,867	111,139	118,726
Less: Net income attributable to noncontrolling interests	298	488	1,054	1,297
Net income attributable to common shareholders	\$37,735	\$ 37,379	\$110,085	\$ 117,429
Earnings (loss) per common share				
Basic:				
Continuing operations attributable to common shareholders	\$0.79	\$ 0.81	\$2.34	\$ 2.52
Discontinued operations	\$0.01	\$ —	\$—	\$ —
Net income attributable to common shareholders	\$0.80	\$ 0.81	\$2.34	\$ 2.52
Diluted:				
Continuing operations attributable to common shareholders	\$0.78	\$ 0.79	\$2.29	\$ 2.47
Discontinued operations	\$0.01	\$ —	\$0.01	\$ —
Net income attributable to common shareholders	\$0.79	\$ 0.79	\$2.30	\$ 2.47

See Notes to Unaudited Condensed Consolidated Financial Statements.

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
 (in thousands)

	Three Months Ended		Nine Months Ended	
	September 26, 2016	September 26, 2015	September 26, 2016	September 26, 2015
Net income	\$38,033	\$ 37,867	\$111,139	\$ 118,726
Other comprehensive income (loss):				
Foreign currency translation adjustment and other	(16,888)	(31,843)	(32,798)	(46,559)
Cumulative translation adjustment related to intercompany loan forgiveness	—	—	—	(2,341)
Amortization of net loss and prior service benefit included in net periodic cost for pension and other post-retirement benefit plans	1,176	695	1,961	2,185
Comprehensive income, before income taxes	22,321	6,719	80,302	72,011
Income tax expense related to items of other comprehensive income (Note 9)	140	220	424	700
Comprehensive income, net of income taxes	22,181	6,499	79,878	71,311
Less: Comprehensive income (loss) related to noncontrolling interests, net of income taxes	—	(443)	(9)	435
Comprehensive income attributable to common shareholders, net of income taxes	\$22,181	\$ 6,942	\$79,887	\$ 70,876

See Notes to Unaudited Condensed Consolidated Financial Statements.

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except per share amounts)

	September 24, 2016	December 26, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 105,722	\$ 117,947
Trade receivables, net	359,734	270,068
Inventories	99,374	93,735
Prepaid assets	36,827	30,198
Other current assets	52,921	47,286
Total current assets	654,578	559,234
Property, plant and equipment, net	767,177	677,959
Goodwill	763,576	438,829
Client relationships, net	318,751	213,374
Other intangible assets, net	77,701	67,430
Deferred tax assets	22,078	40,028
Other assets	86,329	71,643
Total assets	\$ 2,690,190	\$ 2,068,497
Liabilities, Redeemable Noncontrolling Interest and Equity		
Current liabilities:		
Current portion of long-term debt and capital leases	\$ 25,970	\$ 17,033
Accounts payable	65,809	36,675
Accrued compensation	93,558	72,832
Deferred revenue	119,298	81,343
Accrued liabilities	80,524	89,494
Other current liabilities	25,131	12,544
Current liabilities of discontinued operations	1,757	1,840
Total current liabilities	412,047	311,761
Long-term debt, net and capital leases	1,233,189	845,997
Deferred tax liabilities	54,068	48,223
Other long-term liabilities	96,771	89,062
Long-term liabilities of discontinued operations	6,213	7,890
Total liabilities	1,802,288	1,302,933
Commitments and contingencies		
Redeemable noncontrolling interest	15,040	28,008
Equity:		
Preferred stock, \$0.01 par value; 20,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.01 par value; 120,000 shares authorized; 86,262 shares issued and 47,324 shares outstanding as of September 24, 2016 and 85,464 shares issued and 46,698 shares outstanding as of December 26, 2015	863	855
Additional paid-in capital	2,465,193	2,397,960
Retained earnings	120,623	10,538
Treasury stock, at cost 38,938 shares and 38,766 shares as of September 24, 2016 and December 26, 2015, respectively	(1,552,964)	(1,540,738)
Accumulated other comprehensive loss	(165,746)	(135,548)
Total equity attributable to common shareholders	867,969	733,067
Noncontrolling interests	4,893	4,489

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Total equity	872,862	737,556
Total liabilities, redeemable noncontrolling interest and equity	\$ 2,690,190	\$ 2,068,497

See Notes to Unaudited Condensed Consolidated Financial Statements.

5

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
 (in thousands)

	Nine Months Ended	
	September 26, 2016	September 26, 2015
Cash flows relating to operating activities		
Net income	\$ 111,139	\$ 118,726
Less: Income (loss) from discontinued operations, net of income taxes	328	(48)
Income from continuing operations, net of income taxes	110,811	118,774
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	91,116	69,330
Amortization of debt issuance costs and discounts	2,325	1,970
Stock-based compensation	32,647	30,349
Deferred income taxes	(270)	(4,235)
Gain on venture capital investments	(8,518)	(3,604)
Gain on bargain purchase	16	(9,933)
Other, net	4,030	1,101
Changes in assets and liabilities:		
Trade receivables, net	(43,260)	(36,430)
Inventories	(4,352)	(470)
Other assets	(5,702)	8,308
Accounts payable	17,184	(894)
Accrued compensation	8,163	2,238
Deferred revenue	2,169	1,255
Accrued liabilities	(15,182)	22,189
Taxes payable and prepaid taxes	(5,671)	(1,906)
Other liabilities	617	(12,147)
Net cash provided by operating activities	186,123	185,895
Cash flows relating to investing activities		
Acquisition of businesses and assets, net of cash acquired	(597,607)	(211,974)
Capital expenditures	(29,609)	(35,008)
Purchases of investments	(20,278)	(26,315)
Proceeds from sale of investments and distributions from venture capital investments	28,274	24,562
Other, net	3,790	(244)
Net cash used in investing activities	(615,430)	(248,979)
Cash flows relating to financing activities		
Proceeds from long-term debt and revolving credit facility	926,781	453,778
Proceeds from exercises of stock options	21,643	36,587
Payments on long-term debt, revolving credit facility and capital lease obligations	(526,983)	(391,048)
Purchase of treasury stock	(12,226)	(117,431)
Other, net	4,976	6,674
Net cash provided by (used in) financing activities	414,191	(11,440)
Discontinued operations		
Net cash used in operating activities from discontinued operations	(1,434)	(1,265)
Effect of exchange rate changes on cash and cash equivalents	4,325	(10,202)
Net change in cash and cash equivalents	(12,225)	(85,991)
Cash and cash equivalents, beginning of period	117,947	160,023
Cash and cash equivalents, end of period	\$ 105,722	\$ 74,032

See Notes to Unaudited Condensed Consolidated Financial Statements.

6

CHARLES RIVER LABORATORIES INTERNATIONAL, INC.
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Charles River Laboratories International, Inc. (the Company) in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission. The year-end condensed consolidated balance sheet data was derived from the Company's audited financial statements, but does not include all disclosures required by U.S. GAAP. These condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year 2015. The condensed consolidated financial statements, in the opinion of management, reflect all normal and recurring adjustments necessary for a fair statement of the Company's financial position and results of operations.

The Company's fiscal year is typically based on a 52-week year, with each quarter composed of 13 weeks. A 53-week year will occur during the fiscal year 2016, with an additional week included in the fourth quarter.

Segment Reporting

The Company reports its results in three reportable segments: Research Models and Services (RMS), Discovery and Safety Assessment (DSA), and Manufacturing Support (Manufacturing).

During the three months ended June 25, 2016, the Company acquired WRH, Inc. (WIL Research), a provider of safety assessment and contract development and manufacturing (CDMO) services. WIL Research's safety assessment business is reported in the Company's DSA reportable segment and its CDMO business created a new operating segment, Contract Manufacturing, that is reported as part of the Company's Manufacturing reportable segment. In addition, changes in the Company's market strategy for certain services and resulting information provided to the Chief Operating Decision Maker, totaling \$1.9 million of revenue and \$0.2 million of operating income for the nine months ended September 26, 2015, were reclassified from the Company's RMS reportable segment to its Manufacturing reportable segment. The Company reported segment results on this basis for all periods presented.

The revised reportable segments are as follows:

Research Models and Services	Discovery and Safety Assessment	Manufacturing Support
Research Models	Discovery Services	Microbial Solutions
Research Model Services	Safety Assessment	Avian
		Biologics
		Contract Manufacturing

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with U.S. GAAP requires that the Company make estimates and judgments that may affect the reported amounts of assets, liabilities, redeemable noncontrolling interest, revenues, expenses and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, judgments and methodologies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. Changes in estimates are reflected in reported results in the period in which they become known.

Consolidation

The Company's condensed consolidated financial statements reflect its financial statements and those of its subsidiaries in which the Company holds a controlling financial interest. For consolidated entities in which the Company owns or is exposed to less than 100% of the economics, the Company records net income (loss) attributable to noncontrolling interests in its consolidated statements of income equal to the percentage of the economic or ownership interest retained in such entities by the respective noncontrolling parties. Intercompany balances and transactions are eliminated in consolidation.

Summary of Significant Accounting Policies

The Company's significant accounting policies are described in Note 1, "Description of Business and Summary of Significant Accounting Policies," in the Company's Annual Report on Form 10-K for the fiscal year 2015.

Newly Issued Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15, "Classification of Certain Cash Receipts and Cash Payments."