RESMED INC
Form 10-Q
May 08, 2007
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007.

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ______ TO ______

001-15317

Commission file number

ResMed Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

98-0152841

(IRS Employer Identification No.)

14040 Danielson St

Poway, CA 92064-6857

United States Of America

(Address of principal executive offices)

(858) 746 2400

(Registrant s telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [x] Accelerated filer [ ] Non accelerated filer [ ]

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

As of April 27, 2007, 77,839,581 shares of Common Stock ($0.004 par value) were outstanding. This number excludes 2,254,918 shares held by the registrant as treasury shares.

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RESMED INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION Item 1

RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in US$ thousands, except share data)

(Unaudited)

	March 31, 2007	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$240,106	$219,544
Marketable securities available-for-sale (note 3)	19,950	-
Accounts receivable, net of allowance for doubtful accounts of $4,823 at March 31, 2007 and $3,199 at June 30, 2006	153,063	138,147
Inventories, net (note 4)	156,915	116,194
Deferred income taxes	52,148	26,636
Prepaid expenses and other current assets	16,415	9,763
Total current assets	638,597	510,284
Property, plant and equipment, net (note 6)	292,706	245,376
Goodwill, net (note 7)	204,421	195,612
Other intangibles, net (note 8)	46,933	48,897
Other assets	9,149	7,052
Total non current assets	553,209	496,937
Total assets	$1,191,806	$1,007,221
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$44,109	$45,045
Accrued expenses	110,299	40,901
Deferred revenue	18,141	15,344
Income taxes payable	9,811	22,841
Current portion of long-term debt (note 9)	18,683	4,869
Total current liabilities	201,043	129,000
Non current liabilities:		
Deferred income taxes	9,856	12,377
Deferred revenue	12,515	11,484
Long-term debt (note 9)	95,888	116,212
Total non current liabilities	118,259	140,073

Total Liabilities	319,302	269,073
Commitments and contingencies (notes 13 and 14)		
Stockholders Equity:		
Preferred stock, $0.01 par value, 2,000,000 shares authorized; none issued	-	-
Series A Junior Participating preferred stock, $0.01 par value, 250,000 shares authorized; none issued	-	-
Common Stock, $0.004 par value, 200,000,000 shares authorized; issued and outstanding 77,439,397 at March 31, 2007 and 75,670,316 at June 30, 2006 (excluding 2,254,918 and 2,254,918 shares held as Treasury Stock, respectively)	$310	$303
Additional paid-in capital	410,298	353,464
Retained earnings	409,281	370,652
Treasury stock	(41,405)	(41,405)
Accumulated other comprehensive income (note 5)	94,020	55,134
Total stockholders equity	872,504	738,148
Total liabilities and stockholders equity	$1,191,806	$1,007,221

See accompanying notes to unaudited condensed consolidated financial statements.

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PART I - FINANCIAL INFORMATION Item 1

RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income (Unaudited)

(in US$ thousands, except per share data)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
Net revenue	$182,990	$162,280	$525,023	$435,824
Cost of sales [(A)]	69,058	61,414	198,037	163,113
Voluntary product recall expenses (note 10)	59,700	-	59,700	-
Gross profit	54,232	100,866	267,286	272,711
Operating expenses:				
Selling, general and administrative [(A)]	61,335	52,903	172,115	146,478
Research and development [(A)]	13,059	9,143	35,942	26,155
Donation to foundation	-	505	-	760
Amortization of acquired intangible assets	1,730	1,570	5,114	4,661
Restructuring expenses (note 11)	-	-	-	1,124
Total operating expenses	76,124	64,121	213,171	179,178
Income (loss) from operations	(21,892)	36,745	54,115	93,533
Other income (expense), net:				
Interest income (expense), net	1,608	1,220	4,592	(471)
Other, net	(669)	153	(1,176)	1,471
Total other income (expense), net	939	1,373	3,416	1,000
Income (loss) before income taxes	(20,953)	38,118	57,531	94,533
Income taxes	5,588	(11,756)	(18,902)	(29,415)
Net (loss) income	($15,365)	$26,362	$38,629	$65,118
Basic (loss) earnings per share	($0.20)	$0.36	$0.51	$0.91
Diluted (loss) earnings per share (note 2-j)	($0.20)	$0.34	$0.49	$0.87
Basic shares outstanding (in thousands)	77,035	72,549	76,428	71,242
Diluted shares outstanding (in thousands)	77,035	77,403	78,198	76,922
[(A)] Includes stock-based compensation costs as follows:				
Cost of sales	$299	$348	$890	$560
Selling, general and administrative	3,936	2,833	10,593	9,285

Research and development	496	486	1,487	1,535
Total stock-based compensation costs	$4,731	$3,667	$12,970	$11,380

See accompanying notes to unaudited condensed consolidated financial statements.

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PART I - FINANCIAL INFORMATION Item 1

ResMed Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in US$ thousands)

	Nine Months Ended March 31, 2007	2006
Cash flows from operating activities:		
Net income	$38,629	$65,118
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	34,846	29,899
Stock-based compensation costs	12,970	11,380
Amortization of deferred borrowing costs	158	629
Write-down of cost-method investment	-	1,156
Provision for product warranties	1,181	1,189
Voluntary product recall expenses	59,700	-
Foreign currency options revaluation	(751)	4,002
Tax benefit from stock option exercises	(11,290)	(2,173)
Changes in operating assets and liabilities; net of effect of acquisitions:		
Accounts receivable, net	(11,586)	(20,200)
Inventories, net	(33,247)	(17,743)
Prepaid expenses, net deferred income taxes and other current assets	(32,280)	(11,176)
Accounts payable, accrued expenses and other liabilities	5,670	1,637
Net cash provided by operating activities	64,000	63,718
Cash flows from investing activities:		
Purchases of property, plant and equipment	(60,127)	(79,135)
Capitalized interest	(351)	(639)
Patent registration costs	(2,700)	(2,413)
Purchase of non trading investments	(1,063)	(2,527)
Cash paid for business acquisitions, net of cash acquired of $Nil in 2007 and $262 in 2006	(1,912)	(10,368)
Purchases of marketable securities available-for-sale	(21,950)	(2,000)
Proceeds from sale or maturity of marketable securities available-for-sale	2,000	-
Net cash used in investing activities	(86,103)	(97,082)
Cash flows from financing activities:		

Proceeds from issuance of common stock, net	32,678	26,729
Tax benefit from stock option exercises	11,290	2,173
Proceeds from borrowings, net of borrowing costs	9,589	35,000
Repayment of assumed borrowings from acquisitions	-	(2,195)
Repayment of borrowings	(20,000)	-
Net cash provided by financing activities	33,557	61,707
Effect of exchange rate changes on cash	9,108	(4,367)
Net increase in cash and cash equivalents	20,562	23,976
Cash and cash equivalents at beginning of period	219,544	142,185
Cash and cash equivalents at end of period	$240,106	$166,161
Supplemental disclosure of cash flow information:		
Income taxes paid	$48,914	$34,920
Interest paid	4,482	4,082
Fair value of assets acquired in acquisitions	$-	$10,342
Liabilities assumed	-	(7,528)
Goodwill on acquisition	1,588	6,961
Net acquisition costs accrued	324	855
Cash paid for acquisitions, including acquisition costs	$1,912	$10,630

See accompanying notes to condensed consolidated financial statements.

RESMED INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(unaudited)

(1) Organization and Basis of Presentation

ResMed Inc. (referred to herein as we , us , our or the Company) is a Delaware corporation formed in March 1994 holding company for the ResMed Group. Through our subsidiaries, we design, manufacture and market equipment for the diagnosis and treatment of sleep-disordered breathing and other respiratory disorders, including obstructive sleep apnea. Our manufacturing operations are located in Australia, Germany, France and the United States of America (the U.S.). Major distribution and sales sites are located in the U.S., Germany, France, the United Kingdom, Switzerland, Australia and Sweden.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the nine months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending June 30, 2007.

The condensed consolidated financial statements for the three months ended March 31, 2007 and 2006 and the nine months ended March 31, 2007 and 2006 are unaudited and should be read in conjunction with the condensed consolidated financial statements and notes thereto included in our Form 10-K for the year ended June 30, 2006.

(2) Summary of Significant Accounting Policies

(a) Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from management s estimates.

RESMED INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(unaudited)

(2) Summary of Significant Accounting Policies, Continued

(b) Revenue Recognition

Revenue on product sales is generally recorded upon shipment, at which time title transfers to the customer. Revenue on product sales that requires customer acceptance is not recorded until we receive evidence of acceptance. Royalty revenue from license agreements is recorded when earned. Service revenue received in advance from service contracts is initially deferred and recognized ratably over the life of the service contract. Revenue received in advance from rental unit contracts is initially deferred and recognized ratably over the life of the rental contract. Revenue from sale of marketing or distribution rights is initially deferred and recognized ratably as revenue over the life of the contract. Freight charges billed to customers are included in revenue. All freight-related expenses are charged to cost of sales.

We do not recognize revenues to the extent that we offer a right of return or other recourse with respect to the sale of our products, other than returns for product defects or other warranty claims, nor do we recognize revenues if we offer variable sale prices for subsequent events or activities. However, as part of our sales processes we may provide upfront discounts for large orders, one time special pricing to support new product introductions, sales rebates for centralized purchasing entities or price-breaks for regular order volumes. The costs of all such programs are recorded as an adjustment to revenue. In our U.S. sales activities we use a number of manufacturer representatives to sell our products. These representatives are paid a direct commission on sales and act as an integral component of our U.S. sales force. We do not sell our products to these representatives and do not recognize revenue on such shipments. Our products are predominantly therapy-based equipment and require no installation. As such, we have no significant installation obligations.

(c) Cash and Cash Equivalents

Cash equivalents include certificates of deposit, commercial paper and other highly liquid investments and are stated at cost, which approximates market. Investments with original maturities of 90 days or less are considered to be cash equivalents for purposes of the condensed consolidated statements of cash flows.

(d) Inventories

Inventories are stated at the lower of cost, determined principally by the first-in, first-out method, or net realizable value. We review and provide for any product obsolescence in our manufacturing and distribution operations with assessments of individual products and components (based on estimated future usage and sales) being performed throughout the year.

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ResMed Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited)

(2) Summary of Significant Accounting Policies, Continued

(e) Property, Plant and Equipment

Property, plant and equipment, including rental equipment, is recorded at cost. Depreciation expense is computed using the straight line method over the estimated useful lives of the assets, generalbottom" ALIGN="right">15,184,375 15,184,375

Savings & Loans

12,837,951 7,606,501 4,468,320 24,912,772

Software & Services

20,880,128 20,880,128

Technology, Hardware & Equipment

15,947,251 15,947,251

Tobacco Products

2,570,810 2,570,810

Domestic Common Stocks

156,139,162 9,000,760 29,935,284 195,075,206

Banks & Thrifts

	670,210		670,210
Insurance			
	1,476,138		1,476,138
Iron/Steel			
	5,616,000		5,616,000
National Stock Exchange			
		1,521,543	1,521,543
Oil & Gas			
	2,595,344		2,595,344
Pharmaceuticals			
	12,215,754		12,215,754
Real Estate			
	2,744,658		2,744,658
Foreign Common Stocks			
	25,318,104	1,521,543	26,839,647
Limited Partnerships			
	3,128,175		3,128,175
Domestic Hedge Funds			
		57,602,516	57,602,516
Foreign Hedge Funds			
		57,562,444	57,562,444
Domestic Preferred Stocks			
		1,657,760	1,657,760

Domestic Warrants

400,546 400,546

Short Term Investments

5,317,758 5,317,758

TOTAL

$189,903,199 $9,401,306 $148,279,547 $347,584,052

The Fund evaluates transfers into or out of Levels 1, 2 and 3 as of the end of the reporting period. Financial assets were transferred from Level 1 to Level 2 since certain equity prices used a bid price from a data provider at the end of the period and a last quoted sales price from a data provider at the beginning of the period. Financial assets were transferred from Level 2 to Level 1 since certain equity prices used a last sales price from a data provider at the end of the period and a bid price from a data provider at the beginning of the period.

Transfers into and out of Levels 1 and 2 as of December 31, 2013 were as follows:

	Level 1 - Quoted and Unadjusted Prices		Level 2 - Other Significant Observable Inputs	
	Transfers In	Transfers (Out)	Transfers In	Transfers (Out)
Domestic				
Common Stocks	$ 262,356	$ (2,382,343)	$ 2,382,343	$ (262,356)
Total	$ 262,356	$ (2,382,343)	$ 2,382,343	$ (262,356)

The following is a reconciliation of assets in which significant unobservable inputs (Level 3) were used in determining fair value:

Investments in Securities	Balance as of March 31, 2013	Return of Capital	Realized loss	Change in unrealized appreciation/ (depreciation)	Sales proceeds	Transfer into Level 3	Balance as of December 31, 2013
Domestic Common Stocks	$ 22,311,336	$ (110,408)	$ (1,663,628)	$ 9,781,182	$ (383,198)	$ -	$ 29,935,284
Foreign Common Stocks	1,615,421	-	-	(93,878)	-	-	1,521,543
Domestic Hedge Funds	50,791,303	-	-	6,811,213	-	-	57,602,516
Foreign Hedge Funds	50,792,985	-	-	6,769,459	-	-	57,562,444
Domestic Preferred Stocks	1,777,824	-	-	(120,064)	-	-	1,657,760
Total	$ 127,288,869	$ (110,408)	$ (1,663,628)	$ 23,147,912	$ (383,198)	$ -	$ 148,279,547

The table below provides additional information about the Level 3 Fair Value Measurements as of December 31, 2013:

Quantitative Information about Level 3 Fair Value Measurements

	Fair Value (USD)	Valuation Technique	Unobservable Inputs[(a)]	Range
Domestic Common Stocks:				
Banks & Thrifts	$13,703,735	Comparable Company Approach	Discount for lack of marketability	10%
			Price to Tangible Book Value Multiple	1.39x-1.85x
	$15,848	Discounted Cash Flow	Discount for lack of marketability	20%
			Future Cash Distribution	$0.02
Diversified Financial Services	$2,620,900	Comparable Company Approach	Discount for lack of marketability	10%

			Price to Tangible Book Value Multiple	1.46x-1.78x
	$982,221	Direct Offering Price Approach	Transaction Price	$20.48
	$273,060	Indicative Offering Approach	Transaction Price	$0.60
			Book Value Multiple	.90x
Insurance	$7,871,200	Indicative Offering Approach	Transaction Price	$400

Domestic Common Stocks(*Continued*):	Fair Value (USD)	Valuation Technique	Unobservable Inputs[a]	Range
Mortgages & REITS	$0	Book Value Approach	Book Value Multiple	0.00x
Savings & Loans	$4,468,320	Comparable Company Approach	Discount for lack of marketability	10%
			Price to Tangible Book Value Multiple	1.89x
Domestic Preferred Stocks:	$1,657,760	Comparable Security Approach	Spread	1.45%
Foreign Common Stocks:				
National Stock Exchange	$1,521,543	Comparable Company Approach	Discount for lack of marketability	10%
			Price to Earnings Multiple	27.16x

(a) A change to the unobservable input may result in a significant change to the value of the investment as follows:

Unobservable Input	Impact to Value if Input Increases	Impact to Value if Input Decreases
Discount for Lack of Marketability	Decrease	Increase
Price to Tangible Book Value Multiple	Increase	Decrease
Future Cash Distribution	Increase	Decrease
Transaction Price	Increase	Decrease
Book Value Multiple	Increase	Decrease
Spread	Decrease	Increase
Price to Earnings Multiple	Increase	Decrease

Securities Transactions and Investment Income: Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded as of the ex-dividend date, or for certain foreign securities, when the information becomes available to the Fund. Interest income including amortization of premium and accretion of discount on debt securities, as required, is recorded on the accrual basis, using the interest method.

Foreign Currency Translations: The Fund may invest a portion of its assets in foreign securities. In the event that the Fund executes a foreign security transaction, the Fund will generally enter into a forward foreign currency contract to settle the foreign security transaction. Foreign securities may carry more risk than U.S. securities, such as political, market and currency risks. See Foreign Issuer Risk below.

The books and records of the Fund are maintained in U.S. dollars. Foreign currencies, investments and other assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rate prevailing at the end of the period, and purchases and sales of investment securities, income and expenses transacted in foreign currencies are translated at the exchange rate on the dates of such transactions. Foreign currency gains and losses result from fluctuations in exchange rates between trade date and settlement date on securities transactions, foreign currency transactions and the difference between amounts of foreign interest and dividends recorded on the books of the Fund and the amounts actually received.

Foreign Issuer Risk: Investment in non-U.S. issuers may involve unique risks compared to investing in securities of U.S. issuers. These risks may include, but are not limited to: (i) less information about non-U.S. issuers or markets may be available due to less rigorous disclosure, accounting standards or regulatory practices; (ii) many non-U.S. markets are smaller, less liquid and more volatile thus, in a changing market, the advisers may not be able to sell the Fund s portfolio securities at times, in amounts and at prices they consider reasonable; (iii) currency exchange rates or controls may adversely affect the value of the Fund s investments; (iv) the economies of non-U.S. countries may grow at slower rates than expected or may experience downturns or recessions; and, (v) withholdings and other non-U.S. taxes may decrease the Fund s return.

Concentration Risk: The Fund has highly concentrated positions in certain Hedge Funds and may take concentrated positions in other securities. Concentrating investments in a fewer number of securities (including investments in Hedge Funds) may involve a degree of risk that is greater than a fund which has less concentrated investments spread out over a greater number of securities. For example, the value of the Fund s net assets will fluctuate significantly based on the fluctuation in the value of the Hedge Funds in which it invests. In addition, investments in Hedge Funds can be highly volatile and may subject investors to heightened risk and higher operating expenses than another closed-end fund with a different investment focus.

Hedge Fund Risk: The Fund invests a significant portion of its assets in Hedge Funds. The Fund s investments in Hedge Funds are private entities that are not registered under the 1940 Act and have limited regulatory oversight and disclosure obligations. In addition, the Hedge Funds invest in and actively trade securities and other financial instruments using different strategies and investment techniques, which involve significant risks. These strategies and techniques may include, among others, leverage, employing various types of derivatives, short selling, securities lending, and commodities trading. These Hedge Funds may invest a high percentage of their assets in specific sectors of the market in order to achieve a potentially greater investment return. As a result, the Hedge Funds may be more susceptible to economic, political, and regulatory developments in a particular sector of the market, positive or negative, and may experience increased volatility. These and other risks associated with Hedge Funds may cause the Fund s net asset value to be more volatile and more susceptible to the risk of loss than that of other funds with a different investment strategy.

Industry Diversification: The Fund may not invest more than 25% of its assets in any industry or group of industries. While the advisers do not intend to invest more than 25% of the Fund s assets in a single industry, the Fund does not look through its investments in the Hedge Funds, some of which have significant exposure to industries within the financial sector, to determine whether the Fund exceeds the 25% limit. As a result, the Fund may be indirectly concentrated in an industry or group of industries by virtue of the Fund s investments in Hedge Funds.

Indemnifications: Like many other companies, the Fund s organizational documents provide that its officers and directors are indemnified against certain liabilities arising out of the performance of their duties to the Fund. In addition, both in some of its principal service contracts and in the normal course of its business, the Fund enters into contracts that provide indemnifications to other parties for certain types of losses or liabilities. The Fund s maximum exposure under these arrangements is unknown as this could involve future claims against the Fund.

Note 2. Unrealized Appreciation/ (Depreciation)

On December 31, 2013, based on cost of $270,326,364 for federal income tax purposes, aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was $90,579,943 and aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was $13,322,255, resulting in net unrealized appreciation of $77,257,688.

Note 3. Transactions With Affiliated Companies

Transactions during the period with companies in which the Fund owned at least 5% of the voting securities were as follows:

Name of Affiliate	**Beginning Share Balance as of 04/01/13**	**Purchases**	**Sales**	**Ending Share Balance as of 12/31/13**	**Dividend Income**	**Realized Gains (Losses)**	**Value as of 12/31/13**
Perpetual Federal Savings Bank	165,930	-	-	165,930	$86,284	$ -	$ 3,152,670
Redwood Financial, Inc.	40,650	-	-	40,650	12,195	-	843,488
River Valley Bancorp	89,993	-	-	89,993	75,594	-	2,339,818
Third Century Bancorp	110,500	-	-	110,500	6,630	-	707,200
TOTAL					**$180,703**	**$ -**	**$ 7,043,176**

Note 4. Restricted Securities

As of December 31, 2013, investments in securities included issues that are considered restricted. Restricted securities are often purchased in private placement transactions, are not registered under the Securities Act of 1933, may have contractual restrictions on resale, and may be valued under methods approved by the Board as reflecting fair value.

Restricted securities as of December 31, 2013 are as follows:

Description	**Acquisition Date**	**Cost**	**Market Value**	**Value as Percentage of Net Assets**
Bay Pond Partners, LP	10/3/11	$ 39,387,185	$57,602,516	16.9%
Community Bank	2/12/08	912,100	7,999,800	2.4%
First American International	11/29/05	1,052,050	1,241,419	0.4%
Florida Capital Group	8/23/06	2,203,175	8,948	0.0%[(a)]

Forethought Financial Group, Inc. - Class A	11/13/09-9/30/10	4,066,780	7,871,200	2.3%
Independence Financial Group, Inc.	9/13/04	480,000	677,400	0.2%
Maiden Holdings, Ltd., Series C	1/15/09	1,600,000	1,657,760	0.5%
MidCountry Financial Corp.	10/22/04	4,654,500	4,468,320	1.3%
National Bancshares, Inc. Escrow	6/6/06	113,857	15,848	0.0%[(a)]
NSE India, Ltd.	4/30/10	1,517,269	1,521,543	0.4%
Ocwen Structured Investments, LLC	3/20/07 - 8/27/07	1,399,433	273,060	0.1%
South Street Securities Holdings, Inc.	12/8/03	2,500,000	1,943,500	0.6%
Square 1 Financial, Inc.	5/3/05	3,029,000	3,689,322	1.1%
Square 1 Financial, Inc.- Class A	11/7/12	431,379	764,246	0.2%
Tiptree Financial	6/4/07-7/10/09	2,058,848	982,221	0.3%
Wolf Creek Investors (Bermuda) LP, a Wellington Management Investors (Bermuda), Ltd. share class	10/3/11	40,043,650	57,562,444	16.9%
		$ 105,449,226	**$148,279,547**	**43.6%**

[(a)] Less than 0.05% of total net assets.

Note 5. Investments in Hedge Funds

As of December 31, 2013, the Fund held investments in Hedge Funds. The Fund s investments in the Hedge Funds are reported on the Consolidated Portfolio of Investments under the sections titled Hedge Funds.

The Hedge Funds investment objectives are to seek long-term capital appreciation through investment primarily in equity and equity-related securities of companies that derive a major portion of profits or anticipated profits from the global financial services sector and related sectors.

Since the investments in Hedge Funds are not publicly traded, the Fund s ability to make withdrawals from its investments in the Hedge Funds is subject to certain restrictions which vary for each respective Hedge Fund. These restrictions include notice requirements for withdrawals and additional restrictions or charges for withdrawals within a certain time period following initial investment. In addition, there could be circumstances in which such restrictions can include the suspension or delay in withdrawals from the respective Hedge Fund, or limited withdrawals allowable only during specified times during the year. In certain circumstances the Fund may not make withdrawals that occur less than one year following the date of admission to the Hedge Fund. The following table summarizes the Fund s investments in Hedge Funds as of December 31, 2013:

Description	% of Net Assets as of 12/31/13	Value as of 12/31/13	Net Unrealized Gain/(Loss) as of 12/31/13	Mgmt fees	Incentive fees	Redemption Period/ Frequency
Bay Pond Partners, LP	16.9%	$57,602,516	$18,215,331	Annual rate of 1% of net assets	20% of net profits at the end of the fiscal year	June 30 or Dec 31 upon 45 days notice
Wolf Creek Investors (Bermuda) LP, a Wellington Management Investors (Bermuda), Ltd. share class	16.9%	57,562,444	17,518,794	Annual rate of 1% of net assets	20% of net profits at the end of the fiscal year	At the end of each calendar quarter upon 45 days notice
Total	**33.8%**	**$115,164,960**	**$35,734,125**			

The Fund did not have any outstanding unfunded commitments as of December 31, 2013.

Note 6. Line of Credit

On December 7, 2012 the Fund entered into a financing package that includes a Committed Facility Agreement (the Agreement) with BNP Paribas Prime Brokerage, Inc. (BNP) that allowed the Fund to borrow up to $30,000,000 (Initial Maximum Commitment) and a Lending Agreement, as defined below. Borrowings under the Agreement are secured by assets of the Fund that are held by the Fund s custodian in a separate account (the Pledged Collateral). Under the terms of the Agreement, BNP is permitted in its discretion, with 270 calendar days advance notice (the Notice Period), to reduce or call the entire Initial Maximum Commitment. Interest on the borrowing is charged at the one month LIBOR (London Inter-bank Offered Rate) plus 0.80% on the amount borrowed.

For the period ended December 31, 2013, the average amount borrowed under the Agreement and the average interest rate for the amount borrowed were $0 and 0.00%, respectively. As of December 31, 2013, the amount of such outstanding borrowings is $0. The interest rate applicable to the borrowings on December 31, 2013 was 0.00%. As of December 31, 2013 the amount of Pledged Collateral was $0.

The Lending Agreement is a separate side-agreement between the Fund and BNP pursuant to which BNP may borrow a portion of the Pledged Collateral (the Lent Securities) in an amount not to exceed the outstanding borrowings owed by the Fund to BNP under the Agreement. The Lending Agreement is intended to permit the Fund to reduce the cost of its borrowings under the Agreement. BNP has the ability to reregister the Lent Securities in its own name or in another name other than the Fund to pledge, re-pledge, sell, lend or otherwise transfer or use the collateral with all attendant rights of ownership. The Fund may designate any security within the Pledged Collateral as ineligible to be a Lent Security, provided there are eligible securities within the Pledged Collateral in an amount equal to the outstanding borrowing owed by the Fund. During the period in which the Lent Securities are outstanding, BNP must remit payment to the Fund equal to the amount of all dividends, interest or other distributions earned or made by the Lent Securities. The Fund receives income from BNP based on the value of the Lent Securities.

Under the terms of the Lending Agreement, the Lent Securities are marked to market daily, and if the value of the Lent Securities exceeds the value of the then-outstanding borrowings owed by the Fund to BNP under the Agreement (the Current Borrowings), BNP must, on that day, either (1) return Lent Securities to the Fund s custodian in an amount sufficient to cause the value of the outstanding Lent Securities to equal the Current Borrowings; or (2) post cash collateral with the Fund s custodian equal to the difference between the value of the Lent Securities and the value of the Current Borrowings. If BNP fails to perform either of these actions as required, the Fund will recall securities, as discussed below, in an amount sufficient to cause the value of the outstanding Lent Securities to equal the Current Borrowings. The Fund can recall any of the Lent Securities and BNP shall, to the extent commercially possible, return such security or equivalent security to the Fund s custodian no later than three business days after such request. If the Fund recalls a Lent Security pursuant to the Lending Agreement, and BNP fails to return the Lent Securities or equivalent securities in a timely fashion, BNP shall remain liable to the Fund s custodian for the ultimate delivery of such Lent Securities, or equivalent securities, and for any buy-in costs that the executing broker for the sales transaction may impose with respect to the failure to deliver. The Fund shall also have the right to apply and set-off an amount equal to one hundred percent (100%) of the then-current fair market value of such Lent Securities against the Current Borrowings. As of December 31, 2013, the value of securities on loan was $0.

The Board has approved the Agreement and the Lending Agreement. No violations of the Agreement or the Lending Agreement occurred during the period ended December 31, 2013.

Item 2 - Controls and Procedures.

(a) The Registrant s Principal Executive Officer and Principal Financial Officer concluded that the Registrant s disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940 (17 CFR 270.30a-3(c))) were effective as of a date within 90 days of the filing date of this report (the Evaluation Date), based on their evaluation of the effectiveness of the Registrant s disclosure controls and procedures as of the Evaluation Date.

(b) There were no changes in the Registrant s internal control over financial reporting (as defined in Rule 30a-3(d) under the Investment Company Act of 1940 (17 CFR 270.30a-3(d))) that occurred during the Registrant s last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant s internal control over financial reporting.

Item 3 Exhibits.

(a) Certification of Principal Executive Officer and Principal Financial Officer of the Registrant as required by Rule 30a-2(a) under the Investment Company Act of 1940 (17 CFR 270.30a-2(a)) is attached hereto as EX-99.CERT.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Registrant: First Opportunity Fund, Inc.

By: /s/ Stephen C. Miller
Stephen C. Miller, President
(Principal Executive Officer)

Date: February 26, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Stephen C. Miller
Stephen C. Miller, President
(Principal Executive Officer)

Date: February 26, 2014

By: /s/ Nicole L. Murphey
Nicole L. Murphey, Chief Financial Officer, Chief Accounting Officer, Vice President, Treasurer, Asst. Secretary
(Principal Financial Officer)

Date: February 26, 2014