QUIDEL CORP /DE/
Form 10-Q
October 29, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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 Number: 0-10961

QUIDEL CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware	**94-2573850**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10165 McKellar Court, San Diego, California 92121
(Address of principal executive offices, including zip code)
(858) 552-1100
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of October 27, 2010, 28,506,263 shares of common stock were outstanding.

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PART I FINANCIAL INFORMATION
ITEM 1. Financial Statements

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

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,229	$ 89,003
Marketable securities		3,999
Accounts receivable, net	12,862	9,717
Inventories	19,263	15,038
Deferred tax asset current	7,308	6,018
Income tax receivable	5,456	
Prepaid expenses and other current assets	3,499	2,448
Total current assets	55,617	126,223
Property and equipment, net	30,942	21,251
Goodwill	70,411	6,470
Intangible assets, net	54,705	1,943
Deferred tax asset non-current		9,065
Other non-current assets	1,788	1,393
Total assets	$ 213,463	$ 166,345
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,824	$ 5,212
Accrued payroll and related expenses	3,977	5,187
Accrued royalties	1,900	5,513
Current portion of lease obligation	260	234
Income taxes payable	758	6,151
Other current liabilities	5,440	7,227
Total current liabilities	17,159	29,524
Long term debt	73,551	
Lease obligation, net of current portion	6,637	6,527
Deferred tax liability non-current	458	
Income taxes payable	2,360	2,360
Other non-current liabilities	2,104	1,484
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $.001 par value per share; 5,000 shares authorized; none issued or outstanding at September 30, 2010 and December 31, 2009		
Common stock, $.001 par value per share; 50,000 shares authorized; 28,508 and 29,026 shares issued and outstanding at September 30, 2010 and	29	29

December 31, 2009, respectively				
Additional paid-in capital		108,050		112,426
Accumulated other comprehensive income				34
Retained earnings		3,115		13,961
Total stockholders equity		111,194		126,450
Total liabilities and stockholders equity	$	213,463	$	166,345

See accompanying notes.

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Total revenues	$ 28,225	$ 56,152	$ 81,630	$ 97,685
Costs and expenses				
Cost of sales (excludes amortization of intangible assets of $1.7 million, $0.3 million, $4.1 million and $0.9 million, respectively)	12,807	17,670	37,678	36,169
Amortization of inventory fair value adjustment from acquisition			1,118	
Total cost of sales (excludes amortization of intangible assets of $1.7 million, $0.3 million, $4.1 million and $0.9 million, respectively)	12,807	17,670	38,796	36,169
Research and development	6,148	3,157	18,772	9,003
Sales and marketing	5,797	6,400	18,068	16,538
General and administrative	4,759	4,325	13,792	12,125
Amortization of intangible assets from acquired businesses	1,624		3,743	
Amortization of intangible assets from licensed technology	324	345	972	1,040
Business acquisition and integration costs, and restructuring charges	115		2,181	2,038
Total costs and expenses	31,574	31,897	96,324	76,913
Operating (loss) income	(3,349)	24,255	(14,694)	20,772
Other (expense) income				
Interest income	15	53	195	299
Interest expense	(645)	(148)	(1,655)	(459)
Other expense		(5)		(5)
Total other expense	(630)	(100)	(1,460)	(165)
(Loss) income before provision for taxes	(3,979)	24,155	(16,154)	20,607
(Benefit) provision for income taxes	1,882	9,215	(5,309)	7,831
Net (loss) income	$ (5,861)	$ 14,940	$ (10,845)	$ 12,776
Basic and diluted (loss) earnings per share	$ (0.21)	$ 0.50	$ (0.38)	$ 0.42
Shares used in basic per share calculation	28,183	29,713	28,362	30,151
Shares used in diluted per share calculation	28,183	30,149	28,362	30,547

See accompanying notes.

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

	Nine months ended September 30, 2010	Nine months ended September 30, 2009
OPERATING ACTIVITIES:		
Net (loss) income	$ (10,845)	$ 12,776
Adjustments to reconcile net (loss) income to net cash (used for) provided by operating activities:		
Depreciation, amortization and other	8,779	4,478
Stock-based compensation expense	3,881	2,502
Gain on sale of assets	2	
Deferred tax asset	(947)	2,200
Excess tax benefit from share-based compensation		(1,400)
Changes in assets and liabilities:		
Accounts receivable	3,694	(108)
Inventories	864	(1,181)
Income tax receivable	(1,306)	
Prepaid expenses and other current assets	(243)	(920)
Accounts payable	(2,454)	871
Accrued payroll and related expenses	(1,689)	1,996
Accrued royalties	(3,877)	1,993
Accrued income taxes payable	(5,393)	
Other current and non-current liabilities	(3,856)	4,547
Net cash (used for) provided by operating activities	(13,390)	27,754
INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(5,305)	(3,180)
Payment for licensed technology	(2,000)	
Purchase of business, net of cash acquired of $3.1 million	(128,162)	
Purchases of marketable securities		(4,984)
Proceeds from sale of marketable securities	3,999	
Other assets	65	(107)
Net cash used for investing activities	(131,403)	(8,271)
FINANCING ACTIVITIES:		
Payments on lease obligation	(153)	(640)
Purchases of common stock	(9,181)	(19,542)
Borrowing from line of credit	75,000	
Payments on borrowing from line of credit	(3,000)	
Excess tax benefit from share-based compensation		1,400
Proceeds from issuance of common stock, net of cancellations	1,056	1,739
Other	(703)	

Net cash provided by (used for) financing activities	63,019	(17,043)
Net (decrease) increase in cash and cash equivalents	(81,774)	2,440
Cash and cash equivalents, beginning of period	89,003	57,908
Cash and cash equivalents, end of period	$ 7,229	$ 60,348
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 1,655	$ 459
Cash paid during the period for income taxes	$ 6,952	$ 200
NON-CASH INVESTING ACTIVITIES:		
Purchase of capital equipment by incurring current liabilities	$ 369	$ 869

See accompanying notes.

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Quidel Corporation
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Basis of Presentation

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

For 2010 and 2009, the Company s fiscal year will or has ended on January 2, 2011 and January 3, 2010, respectively. For 2010 and 2009, the Company s third quarter ended on October 3, 2010 and September 27, 2009, respectively. For ease of reference, the calendar quarter end dates are used herein. The three and nine month periods ended September 30, 2010 and 2009 both included 13 weeks and 39 weeks, respectively.

Note 2. Acquisition

On February 19, 2010, the Company acquired Diagnostic Hybrids, Inc. (DHI) a privately-held, *in vitro* diagnostics (IVD) company, based in Athens, Ohio, that is a market leader in the manufacturing and commercialization of FDA-cleared direct and culture-based fluorescent IVD assays used in hospital and reference laboratories for a variety of diseases, including viral respiratory infections, herpes, Chlamydia and other viral infections, and thyroid diseases. DHI s direct sales force serves over 700 North American customers, and its products are sold via distributors outside the United States. DHI s products are offered under various brand names including, among others, ELVIS®, R-Mix , Mixed Fresh Cells , FreshCells , ReadyCells and Thyretain . The Company paid approximately $131.2 million in cash to acquire DHI. The Company paid for the acquisition of DHI using cash and cash equivalents on hand and borrowing $75.0 million under the Senior Credit Facility (as defined below). Included in the consolidated statements of operations for the nine months ended September 30, 2010 is revenue and net loss of $24.3 million and $0.4 million, respectively, related to the operations of DHI since acquisition. Net loss of $0.4 million includes the amortization of acquired intangibles and interest expense on the borrowing under the Company s Senior Credit Facility.

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

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

Note 2. Acquisition (Continued)

(in thousands)	
Total cash consideration	$ 131,212
Allocated to:	
Current assets	27,219
Property, plant and equipment	7,799
Other non-current assets	82
In-process research and development	2,110
Intangible assets	53,410
Current liabilities (excluding current portion of note payable)	(4,172)
Note payable to state agency	(1,882)
Other non-current liabilities	(17,295)
Goodwill	63,941
Net assets acquired	$ 131,212

The Company expects to complete the allocation of the purchase price by the end of the first quarter of 2011. The allocation of the purchase price is preliminary pending completion of the final valuation of the deferred tax assets and liabilities resulting from the acquisition. Included in the goodwill amount is $16.5 million related to deferred tax liabilities recorded as a result of the inability to deduct intangible amortization expense associated with the acquisition of DHI. The Company s cost basis in the intangible assets is zero requiring an adjustment to the deferred tax liability to properly capture the Company s ongoing tax rate. The remainder of the goodwill balance reflects the complementary strategic fit that the acquisition of DHI brought to the Company.

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

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

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

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

Note 2. Acquisition (Continued)

(in thousands, except per share data)	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Pro forma total revenues	$ 28,225	$ 68,207	$ 87,335	$ 132,412
Pro forma net (loss) income	$ (5,861)	$ 15,178	$ (13,563)	$ 14,062
Pro forma basic net (loss) earnings per share(1)	$ (0.21)	$ 0.51	$ (0.48)	$ 0.47
Pro forma diluted net (loss) earnings per share(1)	$ (0.21)	$ 0.50	$ (0.48)	$ 0.46

(1) Included in the pro forma $0.48 net loss per share for the nine months ended September 30, 2010 is $5.3 million of transaction expenses relating to the acquisition of DHI, which contributed $0.11 to the pro forma net loss per share.

Note 3. Comprehensive (Loss) Income

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

Note 4. Computation of (Loss) Earnings Per Share

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

Company incurs losses, potentially dilutive shares are not considered in the calculation of net loss per share, as their impact would be anti-dilutive. For periods in which the Company has earnings, out-of-the-money stock options (*i.e.*, the average stock price during the period is below the exercise price of the stock option) are not included in diluted earnings per share as their effect would be anti-dilutive. For the three and nine months ended September 30, 2009, 1.4 million and 1.6 million shares were excluded from the calculation of diluted earnings per share as their effect was anti-dilutive, respectively.

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

	Three months ended September 30,		**Nine months ended September 30,**	
	2010	**2009**	**2010**	**2009**
Shares used in basic (loss) earnings per share (weighted-average common shares outstanding)	28,183	29,713	28,362	30,151
Effect of dilutive stock options and restricted stock awards		436		396
Shares used in diluted (loss) earnings per share calculation	28,183	30,149	28,362	30,547

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

Note 5. Inventories

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

	September 30, 2010	December 31, 2009
Raw materials	$ 8,234	$ 5,307
Work-in-process (materials, labor and overhead)	4,991	3,711
Finished goods (materials, labor and overhead)	6,038	6,020
	$ 19,263	$ 15,038

Note 6. Other Current Liabilities

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

	September 30, 2010	December 31, 2009
Customer incentives	$ 827	$ 4,824
Stock repurchases not settled as of December 31, 2009		1,234
Accrued liability for technology licenses	2,750	
Accrued professional fees	257	345
Current portion of note payable to state agency	210	
Accrued interest on line of credit	29	
Other	1,367	824
	$ 5,440	$ 7,227

Note 7. Income Taxes

The Company s effective tax rate for the nine months ended September 30, 2010 and 2009 was 32.9% and 38.0%, respectively. The Company recognized a tax benefit of $5.3 million and tax expense of $7.8 million for the nine months ended September 30, 2010 and 2009, respectively. For the nine months ended September 30, 2010, the income tax benefit includes a charge related to the re-valuation of the Company s deferred tax assets due to a change in the statutory state tax rate. For the year ended December 31, 2010, the annual effective tax rate is impacted by the deferred tax asset re-valuation discussed above, certain acquisition related non-deductible transaction costs, the exclusion of the federal research and development tax credit and reversing a portion of a tax benefit recognized in 2009 relating to the Company s production deduction.

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

Note 8. Line of Credit

The Company currently has a $120.0 million senior secured syndicated credit facility (the Senior Credit Facility), which matures on October 8, 2013. The Senior Credit Facility bears interest for base rate loans at a rate equal to (i) the higher of (a) the lender s prime rate and (b) the Federal funds rate plus one-half of one percent, plus (ii) the applicable rate or for Eurodollar rate loans the interest rate is equal to (i) the Eurodollar rate, plus (ii) the applicable rate. The applicable rate is generally determined in accordance with a performance pricing grid based on the Company s leverage ratio and ranges from 0.50% to 1.75% for base rate loans and from 1.50% to 2.75% for Eurodollar rate loans. The current applicable rate is subject to adjustment, as described below. The agreement governing the Senior Credit Facility is

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

Note 8. Line of Credit (Continued)

subject to certain customary limitations, including among others: limitation on liens; limitation on mergers, consolidations and sales of assets; limitation on debt; limitation on dividends, stock redemptions and the redemption and/or prepayment of other debt; limitation on investments (including loans and advances) and acquisitions; limitation on transactions with affiliates; and limitation on annual capital expenditures. The Company is also subject to financial covenants which include a funded debt to EBITDA ratio (as defined in the Senior Credit Facility, with adjusted EBITDA generally calculated as earnings before, among other adjustments, interest, taxes, depreciation and amortization) not to exceed 3:00 to 1:00 as of the end of each fiscal quarter, and an interest coverage ratio of not less than 3:50 to 1:00 as of the end of each fiscal quarter. The Senior Credit Facility is secured by substantially all present and future assets and properties of the Company. As of September 30, 2010, the Company had $48.0 million available under the Senior Credit Facility. The Company s ability to borrow under the Senior Credit Facility fluctuates from time to time due to, among other factors, the Company s borrowings under the facility and its funded debt to adjusted EBITDA ratio. At September 30, 2010, the Company had $72.0 million outstanding under the Senior Credit Facility which was borrowed in connection with the acquisition of DHI. At September 30, 2010, the Company was in compliance with all covenants.

During the first quarter of 2010, the Senior Credit Facility was amended for various matters, including amending the credit and security agreement to (i) permit the acquisition of all capital stock of DHI, (ii) allow certain indebtedness and liens related to the DHI acquisition to remain outstanding after the close of the acquisition and (iii) to amend the Senior Credit Facility to increase the aggregate amount of permitted stock repurchases thereunder. In addition, during the third quarter of 2010, the Senior Credit Facility was amended to exclude the application of the funded debt to adjusted EBITDA ratio and interest coverage ratio for the measurement date occurring on December 31, 2010. The amendment also increased the applicable interest rate under the credit agreement by 50 basis points commencing on the date of the amendment and remaining effective until the Company delivers its compliance certificate for the first quarter of 2011 showing compliance with both financial covenants. If such compliance is demonstrated, the applicable rate will decrease by 50 basis points.

Note 9. Stockholders Equity

During the nine months ended September 30, 2010, 161,903 shares of restricted stock were awarded, 79,559 shares of restricted stock were cancelled, 114,330 shares of common stock were issued due to the exercise of stock options and 25,030 shares of common stock were issued in connection with the Company s employee stock purchase plan (the ESPP), resulting in net proceeds to the Company of approximately $1.1 million. Additionally, during the nine months ended September 30, 2010, 740,177 shares of outstanding common stock were repurchased for approximately $9.2 million, which primarily included shares repurchased under the Company s previously announced share repurchase program, but also included 27,677 shares repurchased in connection with payment of minimum tax withholding obligations for certain employees relating to the lapse of restrictions on certain restricted stock awards during the nine months ended September 30, 2010.

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

Note 10. Stock-Based Compensation

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Cost of sales	$ 0.1	$ 0.1	$ 0.5	$ 0.3
Research and development	0.2	0.1	0.4	0.2
Sales and marketing	0.1	0.1	0.3	0.2
General and administrative	0.9	0.5	2.7	2.0
Restructuring charges				(0.2)