ANGIODYNAMICS INC
Form 10-Q
January 09, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 November 30, 2013

OR

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

For the transition period from __________ to __________

Commission file number 0-50761

AngioDynamics, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**11-3146460**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
14 Plaza Drive Latham, New York	**12110**
(Address of principal executive offices)	**(Zip Code)**

(518) 795-1400

Registrant s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $.01	NASDAQ Global Select Market
Preferred Stock Purchase Rights	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No x

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	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 x

Indicate the number of shares outstanding of each of the Issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding as of January 2, 2014**
Common Stock, par value $.01	**35,310,966 shares**

AngioDynamics, Inc. and Subsidiaries

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AngioDynamics, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	Nov 30, 2013	Nov 30, 2012	Nov 30, 2013	Nov 30, 2012
Net sales	$ 88,616	$ 87,007	$ 172,195	$ 170,423
Cost of sales	43,686	42,919	84,783	86,877
Gross profit	44,930	44,088	87,412	83,546
Operating expenses				
Research and development	7,003	7,014	13,712	14,088
Sales and marketing	21,073	18,671	41,036	37,214
General and administrative	6,323	6,910	12,851	13,808
Amortization of intangibles	4,339	4,107	8,623	7,844
Change in fair value of contingent consideration	940	197	1,673	197
Acquisition, restructuring and other items, net	2,679	2,067	4,681	4,589
Medical device excise tax	999		1,975	
Total operating expenses	43,356	38,966	84,551	77,740
Operating income	1,574	5,122	2,861	5,806
Other income (expenses)				
Interest expense	(959)	(1,383)	(2,205)	(2,715)
Interest income		21		103
Other expense	(701)	(628)	(1,389)	(1,216)
Total other income (expenses)	(1,660)	(1,990)	(3,594)	(3,828)
(Loss) income before income tax (expense) benefit	(86)	3,132	(733)	1,978
Income tax expense (benefit)	13	1,163	(208)	730
Net (loss) income	$ (99)	$ 1,969	$ (525)	$ 1,248
(Loss) income per share				
Basic	$ (0.00)	$ 0.06	$ (0.01)	$ 0.04
Diluted	$ (0.00)	$ 0.06	$ (0.01)	$ 0.04

Basic weighted average shares outstanding	35,132	34,827	35,041	34,765
Diluted weighted average shares outstanding	35,132	35,311	35,041	35,279

The accompanying notes are an integral part of these interim consolidated financial statements.

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AngioDynamics, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(in thousands)

	Three Months Ended		Six Months Ended	
	Nov 30, 2013	Nov 30, 2012	Nov 30, 2013	Nov 30, 2012
Net (loss) income	$ (99)	$ 1,969	$ (525)	$ 1,248
Other comprehensive income (loss), before tax:				
Unrealized (loss) gain on interest rate swap	(522)	151	(203)	184
Unrealized gain (loss) on marketable securities		29		(1,059)
Foreign currency translation gain	70	82	140	123
Other comprehensive (loss) income, before tax	(452)	262	(63)	(752)
Income tax benefit (expense) related to items of other comprehensive income	193	(67)	75	324
Other comprehensive (loss) income, net of tax	(259)	195	12	(428)
Total comprehensive (loss) income, net of tax	$ (358)	$ 2,164	$ (513)	$ 820

The accompanying notes are an integral part of these interim consolidated financial statements.

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AngioDynamics, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands, except share data)

	Nov 30, 2013	May 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 15,173	$ 21,802
Marketable securities, at fair value	1,850	2,153
Total cash, cash equivalents, and marketable securities	17,023	23,955
Accounts receivable, net of allowances of $1,584 and $1,272 respectively	48,405	47,791
Inventories	60,052	55,062
Deferred income taxes	6,706	6,591
Prepaid expenses and other	9,387	8,117
Total current assets	141,573	141,516
PROPERTY, PLANT AND EQUIPMENT-AT COST, net	66,390	62,650
OTHER ASSETS	5,543	5,559
INTANGIBLE ASSETS, net	212,195	214,848
GOODWILL	359,736	355,458
DEFERRED INCOME TAXES, long term	9,507	11,007
PREPAID ROYALTIES	546	546
TOTAL ASSETS	$ 795,490	$ 791,584
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 28,336	$ 24,522
Accrued liabilities	17,530	16,426
Current portion of long-term debt	5,000	7,500
Current portion of contingent consideration	12,221	9,207
Other current liabilities	5,992	5,782
Total current liabilities	69,079	63,437
LONG-TERM DEBT, revolving credit facility	41,410	
LONG-TERM DEBT, term loan, net of current portion	93,750	135,000
DEFERRED INCOME TAXES, long term	1,166	
Contingent consideration, net of current portion	60,171	65,842
Other long term liabilities	185	475

Total liabilities		265,761		264,754
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS EQUITY				
Preferred stock, par value $.01 per share, 5,000,000 shares authorized; no shares issued and outstanding				
Common stock, par value $.01 per share, 45,000,000 shares authorized; issued and outstanding 35,305,229 and 35,060,351 shares at November 30, 2013 and May 31, 2013, respectively		353		351
Additional paid-in capital		503,964		500,554
Retained earnings		29,038		29,563
Treasury stock, 142,305 shares, at cost		(2,104)		(2,104)
Accumulated other comprehensive loss		(1,522)		(1,534)
Total stockholders equity		529,729		526,830
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	795,490	$	791,584

The accompanying notes are an integral part of these interim consolidated financial statements.

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AngioDynamics, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Six Months Ended	
	Nov 30, 2013	Nov 30, 2012
Cash flows from operating activities:		
Net (loss) income	$ (525)	$ 1,248
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	12,285	12,161
Stock based compensation	2,423	2,375
Change in fair value of contingent consideration	1,673	197
Deferred income taxes	1,226	2,175
Change in accounts receivable allowances	312	6
Tax effect on exercise of stock options and issuance of performance shares	(146)	(504)
Other	(24)	(571)
Amortization of acquired inventory basis step-up	75	3,445
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(103)	1,497
Inventories	(4,368)	(9,952)
Prepaid expenses and other	(358)	299
Accounts payable and accrued liabilities	3,288	(6,861)
Net cash provided by operating activities	15,758	5,515
Cash flows from investing activities:		
Additions to property, plant and equipment	(7,191)	(4,787)
Acquisition of business, net of cash acquired	(4,169)	(13,908)
Acquisition of intangible and other assets	(150)	(400)
Proceeds from disposal of intangible and other assets		801
Purchases of marketable securities	(25)	(5,134)
Proceeds from sale or maturity of marketable securities	328	16,989
Net cash used in investing activities	(11,207)	(6,439)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	100,000	
Proceeds from borrowings on revolving credit facility	41,410	
Repayment of long-term debt	(143,750)	(3,750)
Deferred financing costs on long-term debt	(677)	
Payment of contingent consideration previously established in purchase accounting	(9,300)	
Proceeds from exercise of stock options and employee stock purchase plan	1,133	476

Net cash used in financing activities	(11,184)	(3,274)
Effect of exchange rate changes on cash and cash equivalents	4	12
Decrease in cash and cash equivalents	(6,629)	(4,186)
Cash and cash equivalents at beginning of period	21,802	23,508
Cash and cash equivalents at end of period	$ 15,173	$ 19,322

	Six Months Ended	
	Nov 30, 2013	Nov 30, 2012
Supplemental disclosure of non-cash investing and financing activities:		
Contractual obligations for acquisition of intangibles and business	$ 4,970	$ 60,302
Contractual obligations for acquisition of fixed assets	724	2,509

The accompanying notes are an integral part of these interim consolidated financial statements.

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AngioDynamics, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

Six Months Ended November 30, 2013

(unaudited)

(in thousands, except share data)

	Common Stock		Additional paid in capital	Retained earnings	Accumulated other comprehensive loss	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balance at May 31, 2013	35,060,351	$ 351	$ 500,554	$ 29,563	$ (1,534)	(142,305)	$ (2,104)	$ 526,830
Net loss				(525)				(525)
Exercise of stock options	54,922		466					466
Tax impact of stock option activity			(146)					(146)
Purchase of common stock under ESPP	71,989	1	667					668
Issuance of performance shares	117,967	1						1
Stock based compensation			2,423					2,423
Other comprehensive income, net of tax					12			12
Balance at November 30, 2013	35,305,229	$ 353	$ 503,964	$ 29,038	$ (1,522)	(142,305)	$ (2,104)	$ 529,729

The accompanying notes are an integral part of these interim consolidated financial statements.

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AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

November 30, 2013 and November 30, 2012

(unaudited)

NOTE A CONSOLIDATED FINANCIAL STATEMENTS

The consolidated balance sheet as of November 30, 2013, the consolidated statement of stockholders equity for the six months ended November 30, 2013, the consolidated statements of income, the consolidated statements of comprehensive income and the consolidated statement of cash flows for the three and six months ended November 30, 2013 and November 30, 2012 have been prepared by us without audit. The consolidated balance sheet as of May 31, 2013 was derived from audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to state fairly the financial position, changes in stockholders equity and comprehensive income, results of operations and cash flows as of and for the period ended November 30, 2013 (and for all periods presented) have been made.

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. It is suggested that these unaudited interim consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended May 31, 2013, filed by us on August 14, 2013. Our most significant accounting policies are disclosed in Note A to the consolidated financial statements included in the aforementioned Form 10-K for the fiscal year ended May 31, 2013. The results of operations in the fiscal periods ended November 30, 2013 and November 30, 2012 are not necessarily indicative of the operating results for the respective full fiscal years.

The unaudited interim consolidated financial statements for the three and six months ended November 30, 2013 and November 30, 2012 include the accounts of AngioDynamics, Inc. and its wholly owned subsidiaries, RITA Medical Systems, LLC, AngioDynamics UK Limited, AngioDynamics Netherlands B.V., NM Holding Company, Inc. (Navilyst), Vortex Medical, Inc. since October 15, 2012 and Clinical Devices B.V. since August 15, 2013, (collectively, the Company). All intercompany balances and transactions have been eliminated.

Recent Developments

Operational Excellence Program

On December 5, 2013, we announced a company-wide operational excellence program designed to save between $15 and $18 million during the course of the next three years. The initiative is expected to create greater efficiencies and drive business performance improvements by focusing on several key elements, including product rationalization, lean manufacturing initiatives, supply chain optimization and enterprise resource planning (ERP) implementation. The plan also incorporates the consolidation of our New York plants to establish a single manufacturing center in Glens Falls and a distribution center in Queensbury. During the course of the three-year program, it is expected that we will reduce our New York employee base by approximately 80-100 positions as a result of this plant consolidation and reorganization.

New Credit Agreement

On September 19, 2013, we entered into a Credit Agreement (the Credit Agreement) with the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A. and Keybank National Association as co-syndication agents, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Keybank National Association as joint bookrunners and joint lead arrangers.

The Credit Agreement provides for a $100 million senior secured term loan facility (Term Facility) and a $100 million senior secured revolving credit facility, which includes up to a $20 million sublimit for letters of credit and a $5 million sublimit for swingline loans (the Revolving Facility , and together with the Term Facility, the Facilities).

The proceeds of the Term Loan and a portion of the proceeds of the Revolving Facility were used to repay our Credit Agreement (the Existing Credit Agreement) dated as of May 22, 2012 with the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A. and Keybank National Association as co-syndication agents, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Keybank National Association as joint bookrunners and joint lead arrangers.

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AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

November 30, 2013 and November 30, 2012

(unaudited)

NOTE A CONSOLIDATED FINANCIAL STATEMENTS (cont d)

The proceeds of the Revolving Facility may be used for general corporate purposes of AngioDynamics and its subsidiaries. The Facilities have a five year maturity. The Term Loan has a quarterly repayment schedule equal to 5%, 5%, 10%, 15% and 65% of its principal amount in years one through five. Interest on both the Term Loan and Revolver will be based on a base rate or Eurodollar rate plus an applicable margin which increases as our total leverage ratio increases, and with the base rate and Eurodollar rate having ranges of 0.50% to 1.25% and 1.50% to 2.25% respectively. After default, the interest rate may be increased by 2.0%. The Revolver will also carry a commitment fee of 0.20% to 0.35% per annum on the unused portion.

Our obligations under the Facilities are unconditionally guaranteed, jointly and severally, by our material direct and indirect domestic subsidiaries (the Guarantors). All obligations of AngioDynamics and the Guarantors under the Facilities are secured by first priority security interests in substantially all of the assets of AngioDynamics and the Guarantors.

On September 19, 2013, we borrowed $100 million under the Term Facility and approximately $41.4 million under the Revolving Facility to repay the Existing Credit Agreement. As of November 30, 2013, $98.8 and $41.4 million were outstanding under the Term Facility and Revolving Facility, respectively. The Credit Agreement includes customary representations, warranties and covenants, and acceleration, indemnity and events of default provisions, including, among other things, two financial covenants. The first financial covenant requires us to maintain, as of the end of each of our fiscal quarters, a ratio of (i) consolidated EBITDA minus consolidated capital expenditures to (ii) consolidated interest expense paid or payable in cash plus scheduled principal payments in respect of indebtedness under the Credit Agreement of not less than 1.35 to 1.00. The second financial covenant requires us to maintain, as of the end of each of our fiscal quarters, a ratio of consolidated total indebtedness to consolidated EBITDA of not greater than 3.75 to 1.00. We were in compliance with both covenants as of November 30, 2013.

On September 19, 2013, we repaid all amounts owed under the Existing Credit Agreement, and as a result, the Existing Credit Agreement was terminated. Pursuant to the terms of the Existing Credit Agreement, we had the option to repay this facility at any time prior to the maturity date without penalty.

Acquisition of Clinical Devices, B.V.

On August 15, 2013 we acquired all the outstanding shares of stock of Clinical Devices, B.V., our exclusive distributor of our fluid management products in the Netherlands. The acquisition includes certain in-process research and development for a next-generation tip location technology. See Note B for further information on the acquisition.

Regulatory Matters

On May 27, 2011, we received a Warning Letter from FDA in connection with its inspection of our Queensbury, NY manufacturing facility. In the Warning Letter, FDA cited deficiencies in the response letter we provided FDA pertaining to the inspection that occurred from January 4 to January 13, 2011. The deficiencies related to our internal procedures for medical device reporting, corrections and removals and complaint handling. We responded to the Warning Letter and completed corrective and preventive actions to address the observations noted.

In December 2011, we initiated a comprehensive Quality Call to Action Program to review and augment our Quality Management Systems at our Queensbury facility. To accelerate implementation of the program, we engaged a team of external regulatory and quality experts and reallocated a significant number of engineering and product development resources to support this corporate initiative. From inception of the Quality Call to Action Program through fiscal 2013, we incurred $3.2 million in direct costs associated with the program.

On February 10, 2012, we received from FDA a Form 483, List of Investigational Observations, in connection with its inspection of our Queensbury facility from November 14, 2011 to February 10, 2012. The Form 483 contained 12 observations related to, among other things, our CAPA (Corrective and Preventive Action) system, MDR (Medical Device Reporting), complaint investigation, corrections and removals, acceptance criteria and training. Some of the observations contained in the Form 483 were repeat observations from the May 27, 2011 Warning Letter.

AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

November 30, 2013 and November 30, 2012

(unaudited)

NOTE A CONSOLIDATED FINANCIAL STATEMENTS (cont d)

On February 13, 2012, we received from FDA a Form 483 in connection with its inspection of our Fremont facility from January 12, 2012 to February 13, 2012. The Form 483 contained six observations related to, among other things, our CAPA system, design controls, risk management and training. We provided responses to FDA within 15 business days of our receipt of the Form 483s.

On September 24, 2012, we received from FDA a Form 483 in connection with its subsequent inspection of our Queensbury, NY facility from September 6 to September 14, and September 19 to September 24. This re-inspection followed our response to the original Form 483 issued by FDA on February 13, 2012. The Form 483 contained 5 observations related to 510(k) decisions, complaint investigations, acceptance criteria, corrective and preventive actions and training. All but one of the observations in the Form 483 related to events that occurred before the date that we had indicated to FDA in our previous responses that our corrective and remediation activities related to our Quality Call to Action would be completed. We provided responses to FDA within 15 business days of our receipt of the Form 483.

On November 28, 2012, FDA completed an inspection of our Manchester, GA facility and no Form 483 observations were issued.

We will continue to work closely with FDA to resolve any outstanding issues. Unless the items raised in the previously disclosed Warning Letters and Form 483s are corrected to FDA s satisfaction or we come to some other arrangement with FDA finally resolving such matters, we may be subject to additional regulatory or legal action, including the issuance of warning letters, injunction, seizure or recall of products, imposition of fines or penalties or operating restrictions on our facilities. Such actions could significantly disrupt our ongoing business and operations and have a material adverse impact on our financial position and operating results.

Acquisition, restructuring and other items, net

Navilyst Acquisition Costs

The three month and six month periods ended November 30, 2013 included approximately $1.6 million and $2.8 million, respectively, in transaction and severance costs related to the Navilyst acquisition. The three month and six month periods ended November 30, 2012 included approximately $1.7 million and $3.9 million, respectively, in transaction and severance costs related to the Navilyst acquisition of May 22, 2012. These costs are included in Acquisition, restructuring and other items, net in the statements of income.

NOTE B ACQUISITIONS

Acquisition of Clinical Devices

On August 15, 2013 we acquired all the outstanding shares of capital stock of Clinical Devices, B.V., exclusive distributor of our fluid management products in the Netherlands. The stock purchase agreement provided for the payment of $3.7 million in cash at closing, which was subject to a working capital adjustment and $400,000 holdback, plus future earn out consideration payable in cash. Earn out consideration is based on our net sales of the fluid management products during the five quarters following the closing as well as milestone payments for achieving regulatory approvals of certain in process research and development for a next-generation tip location technology. The total estimated purchase consideration of $8.7 million includes the upfront payment and the estimated fair value of contingent consideration of $5.0 million. See Note J for additional information related to the contingent Earn out liability.

Goodwill recorded as a result of the acquisition was approximately $4.3 million. Goodwill is not deductible for tax purposes. Intangible assets acquired, other than goodwill, totaled approximately $5.1 million, of which $3.6 million has been identified for in-process research and development (10-year estimated weighted average useful life), $1.4 million as customer relationships (15-year estimated weighted average useful life) and $100,000 as trademarks (5-year estimated weighted average useful life). A deferred tax liability of $1.2 million was also recorded.

The acquisition has been accounted for as a purchase and, accordingly, we have included the results of operations in the financial statements effective August 15, 2013. The pro-forma effects of the acquisition on our income statement and balance sheet were not material.

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AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

November 30, 2013 and November 30, 2012

(unaudited)

NOTE B ACQUISITIONS (cont d)

Acquisition of Microsulis Medical Ltd.

On March 22, 2012, we established a strategic relationship with Microsulis Medical Ltd. (Microsulis), a U.K.-based company specializing in minimally-invasive, microwave ablation technology for the coagulation of soft tissue.

On February 1, 2013, we completed the acquisition of certain assets of Microsulis, which we have accounted for as a business combination, for cash payments at closing totaling $10.0 million, which is subject to a working capital adjustment, a $5.0 million payment due on December 31, 2013 and potential additional cash consideration payable upon performance over the next nine years. We also assumed $1.6 million of liabilities.

The total estimated purchase consideration of $33.6 million includes the initial investment of $5.0 million, closing payments totaling $10.5 million, a $5.0 million payment due on December 31, 2013 and the estimated fair value of contingent consideration (Earn out) of $13.2 million. The $5.0 million payment was made on December 31, 2013. The estimated fair value of contingent consideration is based on projected net sales over the nine year period following the closing. The amount of the Earn out consideration that could be paid on net sales is not limited. See Note J for additional information related to the contingent Earn out liability.

The estimated purchase consideration exceeds the fair value of the acquired net assets by $19.3 million and was recorded as goodwill. Goodwill is deductible for tax purposes. Intangible assets are being amortized over their estimated useful lives of which range from 10 to 15 years. During the three and six month periods ended November 30, 2013, we incurred acquisition related costs of $0 and $60 thousand, respectively, which were expensed to Acquisition, restructuring and other items, net in the statement of income.

Acquisition of Vortex Medical, Inc.

On October 15, 2012, we acquired all the outstanding capital stock of Vortex Medical, Inc., a privately-held company focused on the development and commercialization of medical devices for venous drainage and the removal of thrombus, or blood clots, from occluded blood vessels. Vortex s principal product is the AngioVac® system, which includes the AngioVac Cannula and Circuit. The AngioVac Cannula has a proprietary balloon-actuated, expandable, funnel-shaped distal tip that enhances flow, prevents clogging of the cannula and facilitates en bloc, or whole removal of undesirable intravascular material. Both the AngioVac Cannula and Circuit are FDA-cleared for use during extracorporeal bypass for up to 6 hours. CE Mark approval was received in December 2013.

The total estimated purchase consideration of $75.3 million included the upfront payment of $15.1 million and the estimated fair value of contingent consideration of $60.3 million, $40 million of which is guaranteed. The estimated fair value of contingent consideration is based on projected AngioVac net sales in the ten year period following the closing. The amount of the Earn out consideration that could be paid on AngioVac net sales is not limited. See Note J for additional information related to the contingent Earn out liability.

The purchase consideration exceeded the fair value of the acquired net assets by $29.5 million and was recorded as goodwill. Goodwill is not deductible for tax purposes. Core technologies are being amortized over their estimated useful lives of approximately 15 years as revenues are earned from the sales of the related products.

AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

November 30, 2013 and November 30, 2012

(unaudited)

NOTE C INVENTORIES

Inventories are stated at lower of cost (at standard cost which approximates the first-in, first-out method) or market. Inventories consist of the following:

	Nov 30, 2013	May 31, 2013
	(in thousands)	
Raw materials	$ 24,287	$ 18,362
Work in process	11,557	11,006
Finished goods	24,208	25,694
Inventories	$ 60,052	$ 55,062

NOTE D GOODWILL AND INTANGIBLE ASSETS

Intangible assets other than goodwill and indefinite lived intangible assets are amortized over their estimated useful lives, which range between three and fifteen years, on either a straight-line basis over the expected period of benefit or as revenues are earned from the sales of the related products. We periodically review the estimated useful lives of our intangible assets and review such assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Our determination of impairment is based on estimates of future cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will equal the excess of the carrying value over the fair value of the asset.

Goodwill and intangible assets that have indefinite useful lives are not amortized, but rather, are tested for impairment annually or more frequently if impairment indicators arise. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. Goodwill and intangible assets have been recorded at either incurred or allocated costs. Allocated costs were based on respective fair market values at the date of acquisition.

For goodwill, the impairment test requires a comparison of the estimated fair value of the reporting unit to which the goodwill is assigned to the sum of the carrying value of the assets and liabilities of that unit. If the sum of the carrying value of the assets and liabilities of a reporting unit exceeds the fair value of the reporting unit, the carrying value of the reporting unit s goodwill is reduced to its implied fair value through an adjustment to the goodwill balance, resulting in an impairment charge. Our determination of impairment is based on estimates of future cash flows.

We consider our business to be a single operating segment entity the development, manufacture and sale on a global basis of medical devices for vascular access, surgery, peripheral vascular disease and oncology.

To determine fair value, we considered two market-based approaches and an income approach. Under the market-based approaches, we utilized information regarding our own as well as publicly available industry information to determine earnings multiples and sales multiples. Under the income approach, we determined fair value based on estimated future cash flows of the reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn. We determined the discounted cash flow as the best indicator to determine fair value.

Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates, operating margins, discount rates and future market conditions, among others. These assumptions are highly sensitive and changes in these estimates could result in impairment. Solely for purposes of establishing inputs for the fair value calculations, we assumed that the current economic conditions would continue through fiscal year 2014, followed by a recovery thereafter. In addition, we applied gross margin assumptions consistent with our historical trends at various revenue levels and used an EBITDA exit multiple of 6.0 to calculate the terminal value of the reporting unit. In addition, we used a discount rate of 13.5% to calculate the fair value of our reporting unit.

We completed our annual goodwill impairment test as of December 31, 2012. At December 31, 2012, our reporting unit is the same as our reportable segment. Our assessment of goodwill impairment indicated that the fair value of our reporting unit exceeded its carrying value and therefore goodwill was not impaired. The fair value of our reporting unit exceeded its carrying value by 5%. The fair value of the reporting unit was reconciled to our current stock market capitalization plus an estimated control premium of approximately 60% as of December 31, 2012.

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NOTE D GOODWILL AND INTANGIBLE ASSETS (cont d)

Since early November 2008, our stock market capitalization has at times been lower than our shareholders equity or book value. However, our reporting unit has continued to generate significant cash flows from operations, and we expect to continue to do so in fiscal 2014 and beyond. Furthermore, we believe that a reasonable potential buyer would offer a control premium for our business that would adequately cover the difference between our stock market capitalization and our book value.

We also completed our annual indefinite lived asset (NAMIC trademark) test as of December 31, 2012 using the income approach to determine fair value. Our assessment of the NAMIC trademark indicated that the fair value exceeded the carrying value and therefore the asset was not impaired.

Even though we determined that there was no goodwill impairment as of December 31, 2012, the future occurrence of a potential indicator of impairment, such as a significant adverse change in legal factors or business climate, an adverse action or assessment by a regulator, unanticipated competition, a material negative change in relationships with significant customers, strategic decisions made in response to economic or competitive conditions, loss of key personnel or a more-likely-than-not expectation that the reporting unit or a significant portion of the reporting unit will be sold or disposed of, would require an interim assessment for the reporting unit prior to the next required annual assessment as of December 31, 2013.

It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material. Events that could, in the future, result in impairment include, but are not limited to, declining sales for a significant product or in a significant geographic region.

Adjustments to goodwill for the six months ended November 30, 2013 are as follows (in thousands):

Balance, May 31, 2013	$ 355,458
Acquisition of Clinical Devices B.V.	4,278
Balance, November 30, 2013	$ 359,736

The above change in the carrying value of goodwill is the result of the acquisition of Clinical Devices, B.V. as discussed in Note B.

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NOTE D GOODWILL AND INTANGIBLE ASSETS (cont d)

The balances of intangible assets are as follows:

	November 30, 2013			
	Gross carrying value	Accumulated amortization (in thousands)	Net carrying value	Weighted avg useful life (years)
Product technologies	$ 149,111	$ (28,623)	$ 120,488	10.3
Customer relationships	86,640	(34,593)	52,047	11.9
Trademark-NAMIC	28,600		28,600	Indefinite
Licenses	7,540	(4,949)	2,591	7.5
Trademarks	6,345	(1,476)	4,869	8.0
In-process R&D acquired	3,600		3,600	Indefinite
Distributor relationships	900	(900)		3.0
	$ 282,736	$ (70,541)	$ 212,195	

	May 31, 2013			
	Gross carrying value	Accumulated amortization (in thousands)	Net carrying value	Weighted avg useful life (years)
Product technologies	$ 150,181	$ (24,835)	$ 125,346	10.6
Customer relationships	84,479	(30,595)	53,884	14.8
Trademark-NAMIC	28,600		28,600	Indefinite
Licenses	6,302	(4,501)	1,801	9.0
Trademarks	6,275	(1,058)	5,217	9.9
Distributor relationships	900	(900)		3.0
	$ 276,737	$ (61,889)	$ 214,848	

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AngioDynamics, Inc. and Subsidiaries

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(unaudited)

NOTE E ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	Nov 30, 2013	May 31, 2013
	(in thousands)	
Payroll and related expenses	$ 6,217	$ 6,491
Royalties	2,084	2,034
Income taxes payable	741	
Deferred revenue	1,616	1,573
Accrued severance	1,200	1,602
Sales and franchise taxes	1,329	1,047
Interest rate swap liability	725	523
Other	3,618	3,156
Total	$ 17,530	$ 16,426

NOTE F LONG TERM DEBT

New Credit Agreement

On September 19, 2013, we entered into a Credit Agreement (the Credit Agreement) with the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A. and Keybank National Association as co-syndication agents, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Keybank National Association as joint bookrunners and joint lead arrangers.

The Credit Agreement provides for a $100 million senior secured term loan facility (Term Loan) and a $100 million senior secured revolving credit facility, which includes up to a $20 million sublimit for letters of credit and a $5 million sublimit for swingline loans (the Revolving Facility , and together with the TermLoan, the Facilities).

The proceeds of the Term Loan and a portion of the proceeds of the Revolving Facility were used to repay our Credit Agreement (the Existing Credit Agreement) dated as of May 22, 2012 with the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, Bank of America, N.A. and Keybank National Association as co-syndication agents, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Keybank National Association as joint bookrunners and joint lead arrangers.

The proceeds of the Revolving Facility may be used for general corporate purposes of AngioDynamics and its subsidiaries. The Facilities have a five year maturity. The Term Loan has a quarterly repayment schedule equal to 5%, 5%, 10%, 15% and 65% of its principal amount in years one through five. Interest on both the Term Loan and Revolving Facility will be based on a base rate or Eurodollar rate plus an applicable margin which increases as our total leverage ratio increases, and with the base rate and Eurodollar rate having ranges of 0.50% to 1.25% and 1.50% to 2.25% respectively. After default, the interest rate may be increased by 2.0%. The Revolving Facility will also carry a commitment fee of 0.20% to 0.35% per annum on the unused portion.

Our obligations under the Facilities are unconditionally guaranteed, jointly and severally, by our material direct and indirect domestic subsidiaries (the Guarantors). All obligations of AngioDynamics and the Guarantors under the Facilities are secured by first priority security interests in substantially all of the assets of AngioDynamics and the Guarantors.

In June 2012, we entered in an interest rate swap agreement, (the Swap Agreement), with an initial notional amount of $100 million, to limit the effect of rising of interest rates. The Swap Agreement, which qualified for hedge accounting under authoritative guidance, was a contract to exchange floating interest rate payments for fixed interest rate payments on the outstanding balance of the loan over the life of the agreement without the exchange of the underlying notional amounts. The Swap Agreement provides for a fixed rate of 0.74% above the applicable rate provided for in the Credit Agreement.

AngioDynamics, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(unaudited)

NOTE F LONG TERM DEBT (cont d)

On September 19, 2013, we borrowed $100 million under the Term Facility and approximately $41.4 million under the Revolving Facility to repay the Existing Credit Agreement. As of November 30, 2013, $98.8 million and $41.4 million were outstanding under the Term Facility and Revolving Facility, respectively. The Credit Agreement includes customary representations, warranties and covenants, and acceleration, indemnity and events of default provisions, including, among other things, two financial covenants. The first financial covenant requires us to maintain, as of the end of each of our fiscal quarters, a ratio of (i) consolidated EBITDA minus consolidated capital expenditures to (ii) consolidated interest expense paid or payable in cash plus scheduled principal payments in respect of indebtedness under the Credit Agreement of not less than 1.35 to 1.00. The second financial covenant requires us to maintain, as of the end of each of our fiscal quarters, a ratio of consolidated total indebtedness to consolidated EBITDA of not greater than 3.75 to 1.00. We were in compliance with both covenants as of November 30, 2013.

On September 19, 2013, we repaid all amounts owed under the Existing Credit Agreement, and as a result, the Existing Credit Agreement was terminated. Pursuant to the terms of the Existing Credit Agreement, we had the option to repay this facility at any time prior to the maturity date without penalty.

NOTE G INCOME TAXES

Our effective tax rate was 15% for the second fiscal quarter of 2014 compared with 37% for the prior year period. The current quarter reflects a seven month benefit from the R&D tax credit that expired on December 31, 2013 and a benefit from lower tax rates in foreign jurisdictions in which we operate, offset by non-deductible interest expense related to contingent payments. Additionally during the second fiscal quarter of 2014, our APIC pool, which has been historically reduced when share-based compensation cost previously recognized by us was greater than the deduction allowed for income tax purposes based on the price of our common stock on the date of exercise or vesting, was fully depleted. This depletion resulted in a discrete tax expense which caused our tax benefit related to the loss for the quarter to be reported as a net tax expense. The prior year quarter was affected by a reduction in the Domestic Production Activities Deduction caused by reduced taxable income, the tax impact of non-deductible costs related to the acquisition of Vortex and a tax benefit related to the use of fully reserved capital loss carryforwards made possible by the gain on sale of our PDT laser product line.

Our effective tax rate was a 28% benefit for the first six months of fiscal 2014 compared with 37% expense for the prior year period. The current period reflects a seven month benefit from the R&D tax credit that expired on December 31, 2013 and a benefit from lower tax rates in foreign jurisdictions in which we operate, offset by non-deductible interest expense related to contingent payments. Additionally during the 2014 period, our APIC pool, which has been historically reduced when share-based compensation cost previously recognized by us was greater than the deduction allowed for income tax purposes based on the price of our common stock on the date of exercise or vesting, was fully depleted. The prior period is affected by a reduction in the Domestic Production Activities Deduction caused by reduced taxable income, the tax impact of non-deductible costs related to the acquisition of Vortex and a tax benefit related to the use of fully reserved capital loss carryforwards made possible by the gain on sale of our PDT laser product line. The prior year period reflects a benefit from the R&D tax credit which expired December 31, 2011 and was retroactively reinstated during fiscal year 2013.

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AngioDynamics, Inc. and Subsidiaries

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NOTE H EARNINGS PER COMMON SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of potential common stock. Diluted earnings per share further includes the dilutive effect of potential common stock consisting of stock options and restricted stock units, provided that the inclusion of such securities is not antidilutive. Due to a reported net loss for both the second fiscal quarter of 2014 and fiscal year to date 2014 , our basic and diluted earnings per share calculations are identical for those periods.

The following table sets forth the reconciliation of the weighted-average number of common shares (in thousands):

	Three Months Ended		Six Months Ended	
	Nov 30, 2013	Nov 30, 2012	Nov 30, 2013	Nov 30, 2012
Basic	35,132	34,827	35,041	34,765
Effect of dilutive securities	0	484	0	514
Diluted	35,132	35,311	35,041	35,279

Excluded from the calculation of diluted earnings per common share were options and restricted stock awards issued to employees and non-employees to purchase 2.3 million and 2.7 million shares of common stock for the three months and six months ended November 30, 2013, as their inclusion would be antidilutive. For the three and six month period ended November 30, 2012, options and restricted stock awards issued to employees and non-employees to purchase 3.2 million and 3.0 million shares of common stock were also excluded as their inclusion would have been antidilutive.

NOTE I SEGMENT AND GEOGRAPHIC INFORMATION

We consider our business to be a single operating segment entity the development, manufacture and sale on a global basis of medical devices for vascular access, surgery, peripheral vascular disease and oncology. Our chief operating decision maker (CEO) evaluates the various global product portfolios on a net sales basis. Executives reporting to the CEO include those responsible for operations and supply chain management, research and development, sales, franchise marketing and certain corporate functions. The CEO evaluates profitability, investment and cash flow metrics on a consolidated worldwide basis due to shared infrastructure and resources.

Net sales by product category are summarized below (in thousands):

	Three Months Ended		Six Months Ended	
	Nov 30, 2013	Nov 30, 2012	Nov 30, 2013	Nov 30, 2012
Net sales				
Peripheral Vascular	$ 48,860	$ 45,766	$ 94,340	$ 89,060
Vascular Access	25,571	26,712	50,854	53,342
Oncology/Surgery	12,557	12,006	23,724	23,239
Supply Agreement				