STERIS plc
Form 10-Q
February 08, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended December 31, 2017
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 1-37614
STERIS plc
(Exact name of registrant as specified in its charter)

England and Wales (State or other jurisdiction of incorporation or organization)	98-1203539 (IRS Employer Identification No.)
Rutherford House Stephensons Way Chaddesden, Derby, England (Address of principal executive offices)	DE21 6LY (Zip code)

44 1332 387100
(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 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 pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes x   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.

Large Accelerated Filer x	Accelerated Filer o
Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o
	Emerging Growth Company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. 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 x
The number of ordinary shares outstanding as of February 2, 2018: 84,848,063

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PART 1—FINANCIAL INFORMATION

As used in this Quarterly Report on Form 10-Q, STERIS plc and its subsidiaries together are called “STERIS,” the “Company,” “we,” “us,” or “our,” unless otherwise noted.

ITEM 1. FINANCIAL STATEMENTS

STERIS PLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31, 2017 (Unaudited)	March 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 283,844	$ 282,918
Accounts receivable (net of allowances of $11,708 and $10,357, respectively)	472,060	483,451
Inventories, net	219,495	197,837
Prepaid expenses and other current assets	57,528	53,596
Total current assets	1,032,927	1,017,802
Property, plant, and equipment, net	983,841	915,908
Goodwill and intangibles, net	3,102,361	2,956,190
Other assets	37,875	34,555
Total assets	$ 5,157,004	$ 4,924,455
Liabilities and equity		
Current liabilities:		
Accounts payable	$ 122,107	$ 133,479
Accrued income taxes	6,298	14,640
Accrued payroll and other related liabilities	72,807	78,575
Accrued expenses and other	165,404	154,889
Total current liabilities	366,616	381,583
Long-term indebtedness	1,420,049	1,478,361
Deferred income taxes, net	156,112	171,805
Other liabilities	96,439	82,673
Total liabilities	$ 2,039,216	$ 2,114,422
Commitments and contingencies (see Note 8)		
Preferred shares, with £0.10 par value; 100 shares authorized; 100 issued and outstanding	15	15
Ordinary shares, with £0.10 par value; £17,006 shares aggregate par amount authorized; 84,908 and 84,948 ordinary shares issued and outstanding, respectively	2,063,870	2,085,134
Retained earnings	1,097,726	954,155
Accumulated other comprehensive loss	(54,983)	(240,702)
Total shareholders’ equity	3,106,628	2,798,602
Noncontrolling interests	11,160	11,431
Total equity	3,117,788	2,810,033
Total liabilities and equity	$ 5,157,004	$ 4,924,455

See notes to consolidated financial statements.

STERIS PLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Revenues:				
Product	$309,461	$302,260	$869,623	$866,226
Service	352,439	344,514	1,034,400	1,065,341
Total revenues	661,900	646,774	1,904,023	1,931,567
Cost of revenues:				
Product	162,611	152,879	458,467	450,688
Service	220,701	236,286	644,086	735,372
Total cost of revenues	383,312	389,165	1,102,553	1,186,060
Gross profit	278,588	257,609	801,470	745,507
Operating expenses:				
Selling, general, and administrative	159,143	158,760	468,310	474,326
Goodwill impairment loss	—	58,356	—	58,356
Research and development	15,195	14,591	43,173	43,636
Restructuring expenses	78	18	156	220
Total operating expenses	174,416	231,725	511,639	576,538
Income from operations	104,172	25,884	289,831	168,969
Non-operating expenses, net:				
Interest expense	12,461	10,980	37,610	32,975
Interest income and miscellaneous expense	(225)	(539)	(1,316)	(1,317)
Total non-operating expenses, net	12,236	10,441	36,294	31,658
Income before income tax expense	91,936	15,443	253,537	137,311
Income tax (benefit) expense	(3,404)	19,790	35,538	52,745
Net income (loss)	95,340	(4,347)	217,999	84,566
Less: Net income attributable to noncontrolling interests	559	649	682	744
Net income (loss) attributable to shareholders	$94,781	$(4,996)	$217,317	$83,822
Net income (loss) per share attributed to shareholders				
Basic	$1.12	$(0.06)	$2.55	$0.98
Diluted	$1.11	$(0.06)	$2.53	$0.97
Cash dividends declared per share ordinary outstanding	$0.31	$0.28	$0.90	$0.81

See notes to consolidated financial statements.

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STERIS PLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Net income (loss)	$95,340	$(4,347)	$217,999	$84,566
Less: Net income attributable to noncontrolling interests	559	649	682	744
Net income (loss) attributable to shareholders	94,781	(4,996)	217,317	83,822
Other comprehensive income (loss)				
Unrealized gain (loss) on available for sale securities, (net of taxes of $693, $29, $1,179 and $78, respectively)	2,738	(55)	4,509	(149)
Amortization of pension and postretirement benefit plans costs, (net of taxes of $250, $241, $749 and $723, respectively)	(404)	(391)	(1,212)	(1,171)
Change in cumulative currency translation adjustment	22,742	(180,084)	182,422	(205,079)
Total other comprehensive income (loss)	25,076	(180,530)	185,719	(206,399)
Comprehensive income (loss)	$119,857	$(185,526)	$403,036	$(122,577)

See notes to consolidated financial statements.

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STERIS PLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Nine Months Ended December 31, 2017	2016
Operating activities:		
Net income	$ 217,999	$ 84,566
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	133,855	135,245
Deferred income taxes	(27,318)	46,753
Share-based compensation expense	17,041	14,393
Loss on the disposal of property, plant, equipment, and intangibles, net	819	394
Loss on sale of businesses, net	12,538	42,771
Goodwill impairment loss	—	58,356
Other items	11,410	(26,636)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	15,149	(213)
Inventories, net	(21,567)	(27,368)
Other current assets	(4,843)	4,223
Accounts payable	(10,601)	(5,778)
Accruals and other, net	(16,627)	(37,301)
Net cash provided by operating activities	327,855	289,405
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(113,511)	(112,225)

Proceeds from the sale of property, plant, equipment, and intangibles	2,094	4,785
Proceeds from the sale of businesses, net of cash divested	8,907	136,255
Purchase of investments	—	(6,356)
Acquisition of businesses, net of cash acquired	(46,323)	(65,322)
Net cash used in investing activities	(148,833)	(42,863)
Financing activities:		
Payments on long-term obligations	(22,500)	(15,000)
Payments under credit facilities, net	(58,729)	(30,879)
Deferred financing fees and debt issuance costs	(44)	—
Acquisition related deferred or contingent consideration	(2,064)	(6,352)
Repurchases of ordinary shares	(43,851)	(95,188)
Cash dividends paid to ordinary shareholders	(76,633)	(69,411)
Proceeds from issuance of equity to minority shareholders	—	5,022
Stock option and other equity transactions, net	8,005	3,221
Net cash used in financing activities	(195,816)	(208,587)
Effect of exchange rate changes on cash and cash equivalents	17,720	(21,939)
Increase in cash and cash equivalents	926	16,016
Cash and cash equivalents at beginning of period	282,918	248,841
Cash and cash equivalents at end of period	$ 283,844	$ 264,857

See notes to consolidated financial statements.

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
For the Three and Nine Months Ended December 31, 2017 and 2016
(dollars in thousands, unless noted and except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STERIS plc (“Parent”) was organized in 2014 under the name Solar New HoldCo Limited as a private limited company for the purpose of effecting under the laws of England and Wales the combination (“Combination”) of STERIS Corporation, an Ohio corporation (“Old STERIS”), and Synergy Health plc, a public limited company organized under the laws of England and Wales (“Synergy”). Effective November 2, 2015 the Parent was re-registered as a public company under the name STERIS plc and the Combination closed. As a result of the Combination closing, STERIS plc became the ultimate parent company of Old STERIS and Synergy. Synergy has been re-registered under the name of Synergy Health Limited.

STERIS offers Customers capital equipment products, such as sterilizers and surgical tables; connectivity solutions such as operating room integration; consumable products, such as detergents, gastrointestinal endoscopy accessories, barrier product solutions, and other products and services, including: equipment installation and maintenance, microbial reduction of medical devices, instrument and scope repair solutions, among other services.

Our fiscal year ends on March 31. References in this Quarterly Report to a particular “year” or “year-end” mean our fiscal year. The significant accounting policies applied in preparing the accompanying consolidated financial statements of the Company are summarized below:

Interim Financial Statements

We prepared the accompanying unaudited consolidated financial statements of the Company according to accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and the instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. This means that they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. Our unaudited interim consolidated financial statements contain all material adjustments (including normal recurring accruals and adjustments) management believes are necessary to fairly state our financial condition, results of operations, and cash flows for the periods presented.

These interim consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2017 dated May 26, 2017. The Consolidated Balance Sheet at March 31, 2017 was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

We use the consolidation method to report our investment in our subsidiaries. Therefore, the accompanying consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. We eliminate inter-company accounts and transactions when we consolidate these accounts. Investments in equity of unconsolidated affiliates, over which the Company has significant influence, but not control, over the financial and operating polices, are accounted for primarily using the equity method. These investments are immaterial to the Company's Consolidated Financial Statements.

Use of Estimates

We make certain estimates and assumptions when preparing financial statements according to U.S. GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond our control. Actual results could be materially different from these estimates. We revise the estimates and assumptions as new information becomes available. This means that operating results for the three and nine month periods ended December 31, 2017 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2018.

Recently Issued Accounting Standards Impacting the Company

Recently issued accounting standards impacting the Company are presented in the following table:

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Nine Months Ended December 31, 2017 and 2016
(dollars in thousands, except as noted)

Standard	Date of Issuance	Description	Date of Adoption	Effect on the financial statements or other significant matters
Standards that have recently been adopted				
ASU 2016-07, "Investments - Equity Method and Joint Ventures, Simplifying the Transition to the Equity Method of Accounting" (Topic 323)	March 2016	The standard replaces the previous requirement to retroactively adopt the equity method. The new standard requires that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The standard is effective for annual periods beginning after December 15, 2016 and interim periods within that period. Early adoption is permitted.	First Quarter Fiscal 2018	The prospective adoption of this standard did not have a material impact on our consolidated financial statements.
ASU 2015-11, "Inventory - Simplifying the Measurement of Inventory" (Topic 330)	July 2015	The standard requires an entity to measure inventory within the scope of this update at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years and should be applied prospectively. Early adoption is permitted.	First Quarter Fiscal 2018	The prospective adoption of this standard did not have a material impact on our consolidated financial statements.
ASU 2017-04, "Intangibles - Goodwill and Other, Simplifying the Test for Goodwill Impairment" (Topic 350)	January 2017	The standard eliminates Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedures that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments of this standard, an entity would perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The loss should not exceed the total amount of goodwill allocated to that reporting unit.	Third Quarter Fiscal 2018	The prospective adoption of this standard did not have a material impact on our consolidated financial statements.

Standards that have yet to be adopted	Tax effects should be considered. The standard is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted.

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Nine Months Ended December 31, 2017 and 2016
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ASU 2014-09, "Revenue from Contracts with Customers" and subsequently issued amendments	May 2014	The standard will replace existing revenue recognition standards and significantly expand the disclosure requirements for revenue arrangements. It may be adopted either retrospectively or on a modified retrospective basis to new contracts and existing contracts with remaining performance obligations as of the effective date. The standard is effective for annual periods beginning after December 15, 2017 and interim periods within that period. Early adoption is not permitted before the original public entity effective date of December 15, 2016.	N/A	We plan to adopt this standard on April 1, 2018 using the modified retrospective method. While we are still in the process of evaluating the full impact, we have identified certain historical revenue transactions for which the timing of recognition would have been different under this standard. The actual amount of the cumulative adjustment will depend on the timing of revenue recognition of similar transactions at the end of fiscal 2018. While we cannot determine the specific amount based on information currently available, we do not expect it to have a material impact on our consolidated financial statements. Our preliminary conclusions and assessments remain subject to change. We are in the process of updating our revenue accounting policy and implementing changes to our business processes, disclosures and controls.

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
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ASU 2016-01, "Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Liabilities" (Subtopic 825-10)	January 2016	The standard changes how equity investments are measured and the presentation of changes in the fair value of financial liabilities measured under the fair value option. Presentation and disclosure requirements for financial instruments are also affected. Entities will be required to measure equity investments that do not result in consolidation and are not recorded under the equity method at fair value with changes in fair value recognized in net income. The standard clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale securities. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.
ASU 2016-02, "Leases" (Topic 842)	February 2016	The update will require lessees to record all leases, whether finance or operating, on the balance sheet. An asset will be recorded to represent the right to use the leased asset, and a liability will be recorded to represent the lease obligation. The standard is effective for annual periods beginning after December 15, 2018 and interim periods within that period. Early adoption is permitted.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.
ASU 2016-13, "Measurement of Credit Losses on Financial Instruments"	June 2016	The update requires a financial asset (or group of financial assets) measured at amortized cost to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. The standard is effective for annual periods beginning after December 15, 2019. Early adoption is permitted.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.
ASU 2016-15, "Statement of Cash Flows" (Topic 230)	August 2016	This update provides guidance on the following several specific cash flow issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.

bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions, and separately identifiable cash flows and application of the predominance principle. The standard is effective for annual periods beginning after December 15, 2017 and interim periods within that period. Early adoption is permitted.

(dollars in thousands, except as noted)

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ASU 2016-16, "Income Taxes, Intra-Entity Transfers of Assets Other Than Inventory" (Topic 740)	October 2016	The update improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The new standard requires the recognition of income tax consequences resulting from an intra-entity transfer of an asset other than inventory when the transfer occurs. The standard is effective for annual periods beginning after December 15, 2018. Early adoption is permitted.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.
ASU 2017-07 "Compensation - Retirement Benefits - Improving the Presentation of Net Periodic Pension and Net Periodic Postretirement Benefit Cost" (Topic 715)	March 2017	This standard requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside the subtotal of income from operations, if one is presented. The standard is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.
ASU 2017-09 "Compensation - Stock Compensation" (Topic 718)	May 2017	The update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. This standard is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted.	N/A	We are in the process of evaluating the impact that the standard will have on our consolidated financial statements.

A detailed description of our significant and critical accounting policies, estimates, and assumptions is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2017 dated May 26, 2017. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2017.

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2. Business Acquisitions and Divestitures

Fiscal 2018 Acquisitions

We completed six minor purchases that continued to expand our product and service offerings in the Healthcare Products, Healthcare Specialty Services and the Applied Sterilization Technologies segments. The aggregate purchase price associated with these transactions was approximately $51.6 million, net of cash acquired and including potential contingent consideration of $5.3 million. The purchase price for the acquisitions was financed with both cash on hand and with credit facility borrowings. Acquisition related costs are recorded in the Selling, General and Administrative line of the Consolidated Statements of Income and amounts are not material. Purchase price allocations will be finalized within a measurement period not to exceed one year from closing.

Fiscal 2018 Divestitures

On November 20, 2017, we sold our Synergy Health Healthcare Consumable Solutions ("HCS") business to Vernacare. Annual revenues for the HCS business were approximately $40.0 million and were included in the Healthcare Products segment. We recorded proceeds of $8.2 million, net of cash divested, and subject to a working capital adjustment. We also recognized a pre-tax loss on the sale, subject to final working capital adjustments, of $12.0 million in Selling, general, and administrative expense in the Consolidated Statement of Income.

Fiscal 2017 Acquisitions

Compass Medical, Inc.

On September 16, 2016, we purchased the assets of Compass Medical, Inc., for approximately $16.0 million. The purchase price was financed with credit facility borrowings. Compass Medical, Inc. specialized in the sale and repair of flexible endoscopes. On an annual basis, Compass Medical, Inc. generated revenues of approximately $6.0 million and is being integrated into our Healthcare Specialty Services segment.

Phoenix Surgical Holdings, Ltd. and Endo-Tek LLP

On August 31, 2016, we purchased 100% of the shares of Phoenix Surgical Holdings, Ltd. and the assets of Endo-Tek LLP for approximately $14.3 million combined, net of cash acquired. The purchase price was financed with cash on hand. On an annual basis, these operations, which specialize in the repair of endoscopes, generated approximately $8.0 million in combined revenue. These operations are being integrated into our Healthcare Specialty Services segment.

Medisafe

On July 22, 2016, we purchased 100% of the shares of Medisafe Holdings, Ltd., a U.K. manufacturer of washer/disinfector equipment and related consumables and services for approximately $34.5 million, net of cash acquired. The purchase price was financed with cash on hand. On an annual basis, the Medisafe product line generated approximately $18.0 million in revenue. The acquisition of Medisafe provides washer manufacturing and research and development capabilities in the U.K. Medisafe's products and services are being integrated into our Healthcare Products segment.

The Consolidated Financial Statements include the operating results of acquisitions from the acquisition dates. The table below summarizes the allocation of the purchase price to the net assets acquired based on fair values at the acquisition date for fiscal 2017 acquisitions.

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Nine Months Ended December 31, 2017 and 2016
(dollars in thousands, except as noted)

	Medisafe	Compass	Phoenix and Endo-Tek
Cash	$3,751	$—	$769
Accounts receivable	3,634	629	1,123
Inventory	2,454	659	950
Property, plant and equipment	639	13	1,092
Other assets	—	31	46
Intangible assets	17,151	5,992	7,824
Goodwill	19,599	8,987	5,938
Total Assets	47,228	16,311	17,742
Current liabilities	(5,562)	(309)	(1,373)
Non-current liabilities	(3,398)	—	(1,263)
Total Liabilities	(8,960)	(309)	(2,636)
Net Assets	$38,268	$16,002	$15,106

Fiscal 2017 Divestitures
Netherlands Linen Management Services
On February 9, 2017, we sold our Synergy Health Netherlands Linen Management Services business to EMEA B.V. Annual revenues for Synergy Health Netherlands Linen Management Services were approximately $75 million and were included in the Healthcare Specialty Services segment. We recorded a $42.9 million pre-tax loss on the sale in Selling, general, and administrative expense in the Consolidated Statements of Income as a result of the divestiture. In connection with the divestiture, we entered into a loan agreement with the purchasers to provide financing of up to €15 million for a term of up to 15 years. Loans carry an interest rate of 4 percent for the first four years and 12 percent thereafter. No borrowings were outstanding at December 31, 2017.
US Linen Management Services
On November 3, 2016 we sold our Synergy Health US Linen Management Services business to SRI Healthcare LLC. Annual revenues for the US Linen Management Services were approximately $50 million and were included in the Healthcare Specialty Services segment. We recorded proceeds of $4.5 million and recognized a pre-tax loss on the sale, subject to final adjustments, of $31.2 million in Selling, general, and administrative expense in the Consolidated Statement of Income.
Synergy Health Labs
On September 2, 2016 we sold Synergy Health Laboratory Services to SYNLAB International. Annual revenues for the Synergy Health Labs were approximately $15 million and were included in the Applied Sterilization Technologies segment. We recorded proceeds of $26.3 million, net of cash divested, and recognized a pre-tax gain on the sale of $18.7 million in Selling, general, and administrative expense in the Consolidated Statement of Income.
Applied Infection Control
On August 31, 2016 we completed the sale of our Applied Infection Control ("AIC") product line to DEB USA, Inc., a wholly-owned subsidiary of S.C Johnson & Son, Inc. Annual revenues for the AIC product line were typically less than $50 million and were included in the Healthcare Products segment. We recorded proceeds of $41.8 million and

recognized a pre-tax gain on the sale of $36.2 million in Selling, general, and administrative expense in the Consolidated Statement of Income.

(dollars in thousands, except as noted)

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UK Linen Management Services

On July 1, 2016 we sold our Synergy Health UK Linen Management Services business to STAR Mayan Limited. Annual revenues for the UK Linen Management Services were approximately $50 million and were included in the Healthcare Specialty Services segment. We recorded proceeds of $65.4 million, net of cash divested, and recognized a pre-tax loss on the sale of $66.4 million after allocation of a portion of the identified intangibles and goodwill associated with the Combination in Selling, general, and administrative expense in the Consolidated Statement of Income.

3. Inventories, Net

We use the last-in, first-out (“LIFO”) and first-in, first-out (“FIFO”) cost methods to value inventory. Inventory valued using the LIFO cost method is stated at the lower of cost or market. Inventory valued using the FIFO cost method is stated at the lower of cost or net realizable value. An actual valuation of inventory under the LIFO method is made only at the end of the fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and are subject to the final fiscal year-end LIFO inventory valuation. Inventory costs include material, labor, and overhead. Inventories, net consisted of the following:

	December 31, 2017	March 31, 2017
Raw materials	$ 85,446	$ 65,300
Work in process	32,670	26,538
Finished goods	140,003	140,559
LIFO reserve	(17,640)	(16,706)
Reserve for excess and obsolete inventory	(20,984)	(17,854)
Inventories, net	$ 219,495	$ 197,837

4. Property, Plant and Equipment

Information related to the major categories of our depreciable assets is as follows:

	December 31, 2017	March 31, 2017
Land and land improvements [1]	$ 49,584	$ 46,848
Buildings and leasehold improvements	411,168	393,692
Machinery and equipment	515,353	508,247
Information systems	137,208	119,920
Radioisotope	471,903	436,787
Construction in progress [1]	147,363	77,421
Total property, plant, and equipment	1,732,579	1,582,915
Less: accumulated depreciation and depletion	(748,738)	(667,007)
Property, plant, and equipment, net	$ 983,841	$ 915,908

[1] Land is not depreciated. Construction in progress is not depreciated until placed in service.

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5. Debt

Indebtedness was as follows:

	December 31, 2017	March 31, 2017
Private Placement	$ 980,773	$ 960,684
Deferred financing costs	(3,539)	(3,927)
Credit Agreement	442,815	521,604
Total long term debt	$ 1,420,049	$ 1,478,361

Additional information regarding our indebtedness is included in the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2017 dated May 26, 2017.

6. Additional Consolidated Balance Sheet Information

Additional information related to our Consolidated Balance Sheets is as follows:

	December 31, 2017	March 31, 2017
Accrued payroll and other related liabilities:		
Compensation and related items	$ 18,878	$ 29,777
Accrued vacation/paid time off	11,473	8,651
Accrued bonuses	25,693	20,715
Accrued employee commissions	13,146	16,201
Other postretirement benefit obligations-current portion	2,187	2,187
Other employee benefit plans obligations-current portion	1,430	1,044
Total accrued payroll and other related liabilities	$ 72,807	$ 78,575
Accrued expenses and other:		
Deferred revenues	$ 77,212	$ 71,020
Self-insured risk reserves-current portion	8,550	6,633
Accrued dealer commissions	15,130	16,122
Accrued warranty	6,629	6,861
Asset retirement obligation-current portion	1,350	—
Other	56,533	54,253
Total accrued expenses and other	$ 165,404	$ 154,889
Other liabilities:		
Self-insured risk reserves-long-term portion	$ 15,584	$ 15,584
Other postretirement benefit obligations-long-term portion	13,082	13,821
Defined benefit pension plans obligations-long-term portion	26,809	27,234
Other employee benefit plans obligations-long-term portion	3,643	3,661
Accrued long-term income taxes	10,927	2,089
Asset retirement obligation-long-term portion	9,445	9,953
Other	16,949	10,331
Total other liabilities	$ 96,439	$ 82,673

7. Income Tax Expense

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “TCJA”). The SEC staff issued Staff Accounting Bulletin No.118 (“SAB 118”), which provides guidance on accounting for the tax effects of the TCJA. SAB 118, provides a measurement period that should not extend beyond one year from the TCJA enactment date for companies to complete the accounting under Accounting Standards Codification (“ASC”) Topic 740, Income Taxes. Our accounting for the various elements of the TCJA is incomplete. However, in accordance with SAB 118 guidance, we were able to make what we believe to be reasonable estimates of certain effects and therefore, have recorded a provisional net tax benefit of approximately $25,680 related to the reduction of the U.S. federal corporate income tax rate and the deemed repatriation transition tax. This provisional adjustment was recorded as a discrete item in the period ended December 31, 2017. While we were able to make what we believe to be reasonable estimates of the tax rate reduction and transition tax effects, both items may be affected by other analyses related to the TCJA as well as actual activities to occur in the remainder of the Company’s fiscal year. We are continuing to gather information and will reflect final effects within the measurement period permitted by SAB 118.

Our accounting for the remaining elements of the TCJA is incomplete, as we are not yet able to make reasonable estimates of the effects. Therefore, no provisional adjustments were recorded for those remaining elements in the period ended December 31, 2017.

The effective income tax rates for the three month periods ended December 31, 2017 and 2016 were (3.7)% and 128.1%, respectively. The effective income tax rates for the nine month periods ended December 31, 2017 and 2016 were 14.0% and 38.4%, respectively. During the current year, the tax rates were significantly reduced due to the initially calculated impact from the TCJA. The fiscal 2017 periods were unfavorably impacted by non-deductible goodwill impairment charges occurring in the third quarter.

Income tax expense is provided on an interim basis based upon our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. In determining the estimated annual effective income tax rate, we analyze various factors, including projections of our annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carry forwards, and available tax planning alternatives.

We operate in numerous taxing jurisdictions and are subject to regular examinations by various United States federal, state and local tax authorities, as well as non-United States jurisdictions. We are no longer subject to United States federal examinations for years before fiscal 2015 and, with limited exceptions, we are no longer subject to United States state and local, or non-United States, income tax examinations by tax authorities for years before fiscal 2012. We remain subject to tax authority audits in various jurisdictions wherever we do business. We do not expect the results of these examinations to have a material adverse effect on our consolidated financial statements.

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8. Commitments and Contingencies

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including, without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief.

We believe we have adequately reserved for our current litigation and claims that are probable and estimable, and further believe that the ultimate outcome of these pending lawsuits and claims will not have a material adverse effect on our consolidated financial position or results of operations taken as a whole. Due to their inherent uncertainty, however, there can be no assurance of the ultimate outcome or effect of current or future litigation, investigations, claims or other proceedings (including without limitation the matters discussed below). For certain types of claims, we presently maintain insurance coverage for personal injury and property damage and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

On May 31, 2012, our Albert Browne Limited subsidiary received a warning letter from the FDA regarding chemical indicators manufactured in the United Kingdom. These devices are intended for the monitoring of certain sterilization and other processes. The FDA warning letter states that the agency has concerns regarding operational business processes. We do not believe that the FDA's concerns are related to product performance, or that they result from Customer complaints. We have reviewed our processes with the agency and finalized our remediation measures, and are awaiting FDA reinspection. We do not currently believe that the impact of this event will have a material adverse effect on our financial results.

Civil, criminal, regulatory or other proceedings involving our products or services could possibly result in judgments, settlements or administrative or judicial decrees requiring us, among other actions, to pay damages or fines or effect recalls, or be subject to other governmental, Customer or other third party claims or remedies, which could materially effect our business, performance, prospects, value, financial condition, and results of operations.

For additional information regarding these matters, see the following portions of our Annual Report on Form 10-K for the year ended March 31, 2017 dated May 26, 2017: Item 1 titled “Business - Information with respect to our Business in General - Government Regulation”, and the “Risk Factors” in Item 1A titled "Product related regulations and claims".

From time to time, STERIS is also involved in legal proceedings as a plaintiff involving contract, patent protection, and other claims asserted by us. Gains, if any, from these proceedings are recognized when they are realized.

We are subject to taxation from United States federal, state and local, and non-U.S. jurisdictions. Tax positions are settled primarily through the completion of audits within each individual jurisdiction or the closing of statutes of limitation. Changes in applicable tax law or other events may also require us to revise past estimates. We describe income taxes further in Note 7 to our consolidated financial statements titled, “Income Tax Expense” in this Quarterly Report on Form 10-Q.

Additional information regarding our contingencies is included in Item 2 titled, “Management’s Discussion and Analysis of Financial Conditions and Results of Operations" under "Contingencies".

9. Business Segment Information

We operate and report our financial information in four reportable business segments: Healthcare Products, Healthcare Specialty Services, Life Sciences, and Applied Sterilization Technologies. Corporate, which is presented separately, contains costs that are associated with being a publicly traded company and certain other corporate costs.

Our Healthcare Products segment offers infection prevention and procedural solutions for healthcare providers worldwide, including consumable products, equipment maintenance and installation services, and capital equipment.

Our Healthcare Specialty Services segment provides a range of specialty services for healthcare providers including hospital sterilization services, and instrument and scope repairs. Linen Management Services were divested in fiscal 2017.

Our Life Sciences segment offers consumable products, equipment maintenance and specialty services for pharmaceutical manufacturers and research facilities, and capital equipment.

Our Applied Sterilization Technologies segment offers contract sterilization and laboratory services for medical device and pharmaceutical Customers and others.

Certain minor organizational changes were made to better align with our Customers, resulting in several smaller operations shifting among the segments. The prior period revenues and operating income measures have been recast for comparability.

The accounting policies for reportable segments are the same as those for the consolidated Company. Management evaluates performance and allocates resources based on a segment operating income measure. Operating income (loss) for each segment is calculated as the segment’s gross profit less direct expenses and indirect cost allocations, which result in the full allocation of all distribution and research and development expenses, and the partial allocation of corporate costs. These allocations are based upon variables such as segment headcount and revenues. Products and services are transferred between segments at cost. Corporate includes certain unallocated corporate costs related to being a publicly traded company and legacy pension and post-retirement benefits. Segment operating income excludes certain adjustments which include acquisition related costs, amortization of acquired intangibles, restructuring costs and other charges that management believes may or may not recur with similar materiality or impact on operating income in future periods. Management believes that by excluding these items they gain better insight and greater transparency of the operating performance of the segments, thus aiding them in more meaningful financial trend analysis and operational decision making.

For the three and nine months ended December 31, 2017, revenues from a single Customer did not represent ten percent or more of any reportable segment’s revenues. Additional information regarding our segments is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2017, dated May 26, 2017.

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Financial information for each of our segments is presented in the following table:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Revenues:				
Healthcare Products	$324,895	$324,529	$916,053	$913,882
Healthcare Specialty Services	117,389	129,178	346,934	418,814
Life Sciences	90,895	78,631	261,291	241,548
Applied Sterilization Technologies	128,721	114,436	379,745	357,323
Total revenues	$661,900	$646,774	$1,904,023	$1,931,567
Segment operating income:				
Healthcare Products	$64,033	$65,708	$153,763	$152,531
Healthcare Specialty Services	6,524	1,903	21,841	5,746
Life Sciences	27,164	23,880	76,625	70,595
Applied Sterilization Technologies	43,195	36,647	127,787	118,595
Corporate	(3,506)	(2,420)	(13,573)	(9,143)
Total segment operating income	$137,410	$125,718	$366,443	$338,324
Less: Adjustments				
Restructuring charges [1]	$78	$18	$156	$220
Amortization of acquired intangible assets [2]	16,700	5,598	50,173	42,908
Acquisition and integration related charges [3]	4,428	7,032	11,850	18,893
Loss on fair value adjustment of acquisition related contingent consideration [2]	—	—	—	1,850
Net loss on divestiture of businesses [2]	11,405	28,969	12,538	42,771
Amortization of inventory and property "step up" to fair value [2]	627	(139)	1,895	4,357
Goodwill impairment loss [4]	—	58,356	—	58,356
Total operating income	$104,172	$25,884	$289,831	$168,969

[1] For more information related to restructuring, see our Annual Report on Form 10-K for the year ended March 31, 2017, dated May 26, 2017.
[2] For more information regarding our recent acquisitions and divestitures see Note 2 titled, "Business Acquisitions and Divestitures", as well as our Annual Report on Form 10-K for the year ended March 31, 2017, dated May 26, 2017.
[3] Acquisition and integration related charges include transaction costs and integration expenses associated with acquisitions.
[4] For more information related to our goodwill impairment loss, see our Annual Report on Form 10-K for the year ended March 31, 2017, dated May 26, 2017.

10. Shares and Preferred Shares

Ordinary shares

We calculate basic earnings per share based upon the weighted average number of shares outstanding. We calculate diluted earnings per share based upon the weighted average number of shares outstanding plus the dilutive effect of share equivalents calculated using the treasury stock method.

The following is a summary of shares and share equivalents outstanding used in the calculations of basic and diluted earnings per share:

	Three Months Ended December 31,		Nine Months Ended December 31,	
Denominator (shares in thousands):	2017	2016	2017	2016
Weighted average shares outstanding—basic	85,004	85,074	85,097	85,654
Dilutive effect of share equivalents	715	451	672	472
Weighted average shares outstanding and share equivalents—diluted	85,719	85,525	85,769	86,126

Options to purchase the following number of shares were outstanding but excluded from the computation of diluted earnings per share because the combined exercise prices, unamortized fair values, and assumed tax benefits upon exercise were greater than the average market price for the shares during the periods, so including these options would be anti-dilutive:

	Three Months Ended December 31,		Nine Months Ended December 31,	
(shares in thousands)	2017	2016	2017	2016
Number of share options	294	683	426	558

Preferred Shares

Pursuant to an engagement letter dated October 23, 2015, we issued 100,000 preferred shares, par value of £0.10 each, for an aggregate consideration of approximately $15, in satisfaction of debt owed to a service provider. The holders of the preferred shares are entitled to a fixed cumulative preferential annual dividend of 5 percent on the amount paid periodically on the preferred shares respectively held by them. On a return of capital of the Company whether on liquidation or otherwise, the holders of the preferred shares shall be entitled to receive the sum of £0.10 per preferred share plus any accrued but unpaid dividends out of the assets of the Company available for distribution to its shareholders, but will not be entitled to any further participation in the assets of the Company. The holders of the preferred shares will have no right to attend, speak or vote, whether in person or by proxy, at any general meeting of the Company or any meeting of a class of members of the Company in respect of the preferred shares and will not be entitled to receive any notice of meetings.

11. Repurchases of Ordinary Shares

On August 9, 2016, the Company announced that its Board of Directors had authorized the purchase of up to $300 million of our ordinary shares. We may enter into share repurchase contracts until August 2, 2021 to effect these purchases. Shares may be repurchased from time to time through open market transactions, including 10b5-1 plans. The repurchase program may be suspended or discontinued at any time. During the first nine months of fiscal 2018, we repurchased 436,547 of our ordinary shares for the aggregate amount of $38,171 pursuant to this authorization. During the first nine months of fiscal 2018, we obtained 114,809 of our ordinary shares in the aggregate amount of $6,197 in connection with share based compensation award programs.

(dollars in thousands, except as noted)

12. Share-Based Compensation

We maintain a long-term incentive plan that makes available shares for grants, at the discretion of the Compensation Committee of the Board of Directors, or the Board of Directors, to officers, directors, and key employees in the form of stock options, restricted shares, restricted share units, stock appreciation rights and share grants. We satisfy share award incentives through the issuance of new ordinary shares.

Stock options provide the right to purchase our shares at the market price on the date of grant, subject to the terms of the option plan and agreements. Generally, one-fourth of the stock options granted become exercisable for each full year of employment following the grant date. Stock options granted generally expire ten years after the grant date, or in some cases earlier if the option holder is no longer employed by us. Restricted shares and restricted share units generally cliff vest after a four year period or vest in tranches of one-fourth of the number granted for each full year of employment after the grant date. As of December 31, 2017, 4,994,447 shares remained available for grant under the long-term incentive plan.

The fair value of stock option awards was estimated at their grant date using the Black-Scholes-Merton option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics that are not present in our option grants. If the model permitted consideration of the unique characteristics of employee stock options, the resulting estimate of the fair value of the stock options could be different. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Income. The expense is classified as cost of goods sold or selling, general and administrative expenses in a manner consistent with the employee’s compensation and benefits.

The following weighted-average assumptions were used for options granted during the first nine months of fiscal 2018 and 2017:

	Fiscal 2018	Fiscal 2017
Risk-free interest rate	2.01%	1.29%
Expected life of options	5.7 years	5.7 years
Expected dividend yield of stock	1.58%	1.54%
Expected volatility of stock	22.08%	22.92%

The risk-free interest rate is based upon the U.S. Treasury yield curve. The expected life of options is reflective of historical experience, vesting schedules and contractual terms. The expected dividend yield of stock represents our best estimate of the expected future dividend yield. The expected volatility of stock is derived by referring to our historical stock prices over a time frame similar to that of the expected life of the grant. An estimated forfeiture rate of 2.25% and 1.85% was applied in fiscal 2018 and 2017, respectively. This rate is calculated based upon historical activity and represents an estimate of the granted options not expected to vest. If actual forfeitures differ from this calculated rate, we may be required to make additional adjustments to compensation expense in future periods. The assumptions used above are reviewed at the time of each significant option grant, or at least annually.

A summary of share option activity is as follows:

	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2017	1,945,274	$ 50.28		
Granted	429,360	77.75		
Exercised	(267,687)	34.37		

Forfeited	(17,497)	67.13		
Outstanding at December 31, 2017	2,089,450	$ 57.82	6.7 years	$ 61,946
Exercisable at December 31, 2017	1,201,768	$ 47.97	5.4 years	$ 47,473

We estimate that 869,452 of the non-vested stock options outstanding at December 31, 2017 will ultimately vest.

(dollars in thousands, except as noted)

The aggregate intrinsic value in the table above represents the total pre-tax difference between the $87.47 closing price of our ordinary shares on December 31, 2017 over the exercise prices of the stock options, multiplied by the number of options outstanding or outstanding and exercisable, as applicable. The aggregate intrinsic value is not recorded for financial accounting purposes and the value changes daily based on the daily changes in the fair market value of ordinary shares.

The total intrinsic value of stock options exercised during the first nine months of fiscal 2018 and fiscal 2017 was $12,495 and $4,160, respectively. Net cash proceeds from the exercise of stock options were $9,080 and $3,221 for the first nine months of fiscal 2018 and fiscal 2017, respectively.

The weighted average grant date fair value of stock option grants was $15.51 and $13.42 for the first nine months of fiscal 2018 and fiscal 2017, respectively.

Stock appreciation rights (“SARS”) carry generally the same terms and vesting requirements as stock options except that they are settled in cash upon exercise and therefore, are classified as liabilities. The fair value of the outstanding SARS as of December 31, 2017 and 2016 was $1,733 and $1,736, respectively.

A summary of the non-vested restricted share and share unit activity is presented below:

	Number of Restricted Shares	Number of Restricted Share Units	Weighted-Average Grant Date Fair Value
Non-vested at March 31, 2017	780,526	34,013	$ 60.87
Granted	233,107	23,259	77.93
Vested	(206,388)	(21,181)	54.86
Forfeited	(33,758)	(660)	68.73
Non-vested at December 31, 2017	773,487	35,431	$ 67.64

Restricted shares granted are valued based on the closing stock price at the grant date. The value of restricted shares and restricted share units that vested during the first nine months of fiscal 2018 was $12,484.

As of December 31, 2017, there was a total of $40,019 in unrecognized compensation cost related to non-vested share-based compensation granted under our share-based compensation plan. We expect to recognize the cost over a weighted average period of 2.2 years.

13. Financial and Other Guarantees

We generally offer a limited parts and labor warranty on capital equipment. The specific terms and conditions of those warranties vary depending on the product sold and the countries where we conduct business. We record a liability for the estimated cost of product warranties at the time product revenues are recognized. The amounts we expect to incur on behalf of our Customers for the future estimated cost of these warranties are recorded as a current liability on the accompanying Consolidated Balance Sheets. Factors that affect the amount of our warranty liability include the number and type of installed units, historical and anticipated rates of product failures, and material and service costs per claim. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

Changes in our warranty liability during the first nine months of fiscal 2018 were as follows:

	Warranties
Balance, March 31, 2017	$ 6,861
Warranties issued during the period	8,953
Settlements made during the period	(9,185)
Balance, December 31, 2017	$ 6,629

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(dollars in thousands, except as noted)

We also sell product maintenance contracts to our Customers. These contracts range in terms from one to five years and require us to maintain and repair the product over the maintenance contract term. We initially record amounts due from Customers under these contracts as a liability for deferred service contract revenue on the accompanying Consolidated Balance Sheets within "Accrued expenses and other." The liability recorded for such deferred service revenue was $33,311 and $34,264 as of December 31, 2017 and March 31, 2017, respectively. Such deferred revenue is then amortized on a straight-line basis over the contract term and recognized as service revenue on our accompanying Consolidated Statements of Income. The activity related to the liability for deferred service contract revenue is excluded from the table presented above.

14. Derivatives and Hedging

From time to time, we enter into forward contracts to hedge potential foreign currency gains and losses that arise from transactions denominated in foreign currencies, including inter-company transactions. We may also enter into commodity swap contracts to hedge price changes in nickel that impact raw materials included in our cost of revenues. During the first nine months of fiscal 2018, we also entered into forward foreign currency contracts in order to hedge a portion of our expected non-U.S. dollar denominated earnings against our reporting currency, the U.S. dollar. These foreign currency exchange contracts will mature during fiscal 2018. We did not elect hedge accounting for these forward foreign currency contracts; however, we may seek to apply hedge accounting in future scenarios. We do not use derivative financial instruments for speculative purposes.

None of these contracts are designated as hedging instruments and do not receive hedge accounting treatment; therefore, changes in their fair value are not deferred but are recognized immediately in the Consolidated Statements of Income. At December 31, 2017, we held foreign currency forward contracts to buy 128.6 million Mexican pesos, 13.7 million Canadian dollars and 3.8 million Brazilian reais; and to sell 3.8 million euros and 1.6 million British pounds sterling. At December 31, 2017, we held commodity swap contracts to buy 177.2 thousand pounds of nickel.

Balance sheet location	Asset Derivatives Fair Value at December 31, 2017	Asset Derivatives Fair Value at March 31, 2017	Liability Derivatives Fair Value at December 31, 2017	Liability Derivatives Fair Value at March 31, 2017
Prepaid & Other	$ 502	$ 160	$ —	$ —
Accrued expenses and other	—	—	839	35

The following table presents the impact of derivative instruments and their location within the Consolidated Statements of Income:

	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income Three Months Ended December 31, 2017	2016	Nine Months Ended December 31, 2017	2016
Foreign currency forward contracts	Selling, general and administrative	$ (842)	$ (945)	$ (1,358)	$ (2,495)
Commodity swap contracts	Cost of revenues	$ 200	$ (24)	$ 226	$ 392

Additionally, we hold our debt in multiple currencies to fund our operations and investments in certain subsidiaries. We designate portions of foreign currency denominated intercompany loans as hedges of portions of net investments in foreign operations. Net debt designated as non-derivative net investment hedging instruments totaled $66.4 million at December 31, 2017. These hedges are designed to be fully effective and any associated gain or loss is recognized in Accumulated Other Comprehensive Income and will be reclassified to income in the same period when a gain or loss related to the net investment in the foreign operation is included in income.

(dollars in thousands, except as noted)

15. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. We estimate the fair value of financial assets and liabilities using available market information and generally accepted valuation methodologies. The inputs used to measure fair value are classified into three tiers. These tiers include Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring the entity to develop its own assumptions.

The following table shows the fair value of our financial assets and liabilities at December 31, 2017 and March 31, 2017:

			Fair Value Measurements					
	Carrying Value		Quoted Prices in Active Markets for Identical Assets Level 1		Significant Other Observable Inputs Level 2		Significant Unobservable Inputs Level 3	
	December 31	March 31	December 31	March 31	December 31	March 31	December 31	March 31
Assets:								
Cash and cash equivalents	$283,844	$282,918	$283,844	$282,918	$ —	$ —	$ —	$ —
Forward and swap contracts [1]	502	160	—	—	502	160	—	—
Investments [2]	$19,172	12,552	19,172	12,552	—	—	—	—
Liabilities:								
Forward and swap contracts [1]	$839	$35	$—	$—	$ 839	$ 35	$ —	$ —
Deferred compensation plans [2]	1,818	1,677	1,818	1,677	—	—	—	—
Long term debt [3]	1,420,049	1,478,361	—	—	1,443,978	1,496,966	—	—
Contingent consideration obligations [4]	8,113	4,451	—	—	—	—	8,113	4,451

[1] The fair values of forward and swap contracts are based on period-end forward rates and reflect the value of the amount that we would pay or receive for the contracts involving the same notional amounts and maturity dates.

[2] We maintain a frozen domestic non-qualified deferred compensation plan covering certain employees, which allows for the deferral of payment of previously earned compensation for an employee-specified term or until retirement or termination. Amounts deferred can be allocated to various hypothetical investment options (compensation deferrals have been frozen under the plan). We hold investments to satisfy the future obligations of the plan. Changes in the value of the investment accounts are recognized each period based on the fair value of the underlying investments. Employees who made deferrals are entitled to receive distributions of their hypothetical account balances (amounts deferred, together with earnings (losses)). We also hold an investment in the common stock of Servizi Italia, S.p.A, a leading provider of integrated linen washing and outsourced sterile processing services to hospital Customers. Changes in the value of the investment are recognized each period based on the fair value of the investment.

[3] We estimate the fair value of our long-term debt using discounted cash flow analyses, based on our current incremental borrowing rates for similar types of borrowing arrangements.

[4] Contingent consideration obligations arise from business acquisitions. The fair values are based on discounted cash flow analyses reflecting the possible achievement of specified performance measures or events and captures the contractual nature of the contingencies, commercial risk, and the time value of money. Contingent consideration

obligations are classified in the consolidated balance sheets as accrued expense (short-term) and other liabilities (long-term), as appropriate based on the contractual payment dates.

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis at December 31, 2017 are summarized as follows:

	Contingent Consideration
Balance at March 31, 2017	$ 4,451
Additions	5,310
Payments	(1,735)
Currency translation adjustments	87
Balance at December 31, 2017	$ 8,113

Information regarding our investments is as follows:

	Investments at December 31, 2017 and March 31, 2017							
	Cost		Unrealized Gains [1]		Unrealized Losses [1]		Fair Value	
	December 31	March 31	December 31	March 31	December 31	March 31	December 31	March 31
Available-for-sale securities:								
Marketable equity securities and other	$11,037	$11,037	$6,418	$ —	$ —	$ (72)	$17,455	$10,965
Mutual funds	1,069	1,091	648	496	—	—	1,717	1,587
Total available-for-sale securities	$12,106	$12,128	$7,066	$ 496	$ —	$ (72)	$19,172	$12,552

[1] Amounts reported include the impact of currency movements relative to the U.S. dollar.

16. Reclassifications Out of Accumulated Other Comprehensive Income (Loss)

Amounts in Accumulated Other Comprehensive Income (Loss) are presented net of the related tax. Currency Translation is not adjusted for income taxes. Changes in our Accumulated Other Comprehensive Income (Loss) balances, net of tax, for the three and nine months ended December 31, 2017 were as follows:

	Gain (Loss) on Available for Sale Securities [1]		Defined Benefit Plans [2]		Currency Translation [3]		Total Accumulated Other Comprehensive Income (Loss)	
	Three Months	Nine Months	Three Months	Nine Months	Three Months	Nine Months	Three Months	Nine Months
Beginning Balance	$1,949	$ 178	$(3,163)	$(2,355)	$(78,845)	$(238,525)	$(80,059)	$(240,702)
Other Comprehensive Income (Loss) before reclassifications	2,729	4,474	120	360	22,742	182,422	25,591	187,256
Amounts reclassified from Accumulated Other Comprehensive Income (Loss)	9	35	(524)	(1,572)	—	—	(515)	(1,537)
Net current-period Other Comprehensive Income (Loss)	2,738	4,509	(404)	(1,212)	22,742	182,422	25,076	185,719
Balance at December 31, 2017	$4,687	$ 4,687	$(3,567)	$(3,567)	$(56,103)	$(56,103)	$(54,983)	$(54,983)

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STERIS PLC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)
For the Three and Nine Months Ended December 31, 2017 and 2016
(dollars in thousands, except as noted)

Changes in our Accumulated Other Comprehensive Income (Loss) balances, net of tax, for the three and nine months ended December 31, 2016 were as follows:

	Gain (Loss) on Available for Sale Securities (1)		Defined Benefit Plans (2)		Currency Translation (3)		Total Accumulated Other Comprehensive Income (Loss)	
	Three Months	Nine Months	Three Months	Nine Months	Three Months	Nine Months	Three Months	Nine Months
Beginning Balance	$(767)	$(673)	$4,328	$5,108	$(97,589)	$(72,594)	$(94,028)	$(68,159)
Other Comprehensive Income (Loss) before reclassifications	(68)	(199)	102	308	(180,084)	(205,079)	(180,050)	(204,970)
Amounts reclassified from Accumulated Other Comprehensive Income (Loss)	13	50	(493)	(1,479)	—	—	(480)	(1,429)
Net current-period Other Comprehensive Income (Loss)	(55)	(149)	(391)	(1,171)	(180,084)	(205,079)	(180,530)	(206,399)
Balance at December 31, 2016	$(822)	$(822)	$3,937	$3,937	$(277,673)	$(277,673)	$(274,558)	$(274,558)

(1) Realized gain (loss) on available for sale securities is reported in the Interest income and miscellaneous expense line of the Consolidated Statements of Income.
(2) Amortization (gain) of defined benefit pension items is reported in the Selling, general and administrative expense line of the Consolidated Statements of Income.
(3) The effective portion of gain or loss on net debt designated as non-derivative net investment hedging instruments is recognized in Accumulated Other Comprehensive Income and is reclassified to income in the same period when a gain or loss related to the net investment is included in income.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders of STERIS plc

We have reviewed the consolidated balance sheet of STERIS plc and subsidiaries (“the Company”) as of December 31, 2017, and the related consolidated statements of income, comprehensive income and cash flows for the three-month and nine-month periods ended December 31, 2017 and 2016. These financial statements are the responsibility of the Company’s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of STERIS plc and subsidiaries as of March 31, 2017, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the year then ended (not presented herein) and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated May 26, 2017. In our opinion, the accompanying consolidated balance sheet of STERIS plc and subsidiaries as of March 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio
February 8, 2018

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

In Management’s Discussion and Analysis of Financial Condition and Results of Operations (the “MD&A”), we explain the general financial condition and the results of operations for STERIS including:

- what factors affect our business;
- what our earnings and costs were in each period presented;
- why those earnings and costs were different from prior periods;
- where our earnings came from;
- how this affects our overall financial condition;
- what our expenditures for capital projects were; and
- where cash will come from to fund future debt principal repayments, growth outside of core operations, repurchases of shares, pay cash dividends and fund future working capital needs.

As you read the MD&A, it may be helpful to refer to information in our consolidated financial statements, which present the results of our operations for the third quarter and first nine months of fiscal 2018 and fiscal 2017. It may also be helpful to read the MD&A in our Annual Report on Form 10-K for the year ended March 31, 2017, dated May 26, 2017. In the MD&A, we analyze and explain the period-over-period changes in the specific line items in the Consolidated Statements of Income. Our analysis may be important to you in making decisions about your investments in STERIS.

Financial Measures

In the following sections of the MD&A, we may, at times, refer to financial measures that are not required to be presented in the consolidated financial statements under U.S. GAAP. We sometimes use the following financial measures in the context of this report: backlog; debt-to-total capital; net debt-to-total capital; and days sales outstanding. We define these financial measures as follows:

- Backlog – We define backlog as the amount of unfilled capital equipment purchase orders at a point in time. We use this figure as a measure to assist in the projection of short-term financial results and inventory requirements.
- Debt-to-total capital – We define debt-to-total capital as total debt divided by the sum of total debt and shareholders’ equity. We use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.
- Net debt-to-total capital – We define net debt-to-total capital as total debt less cash (“net debt”) divided by the sum of net debt and shareholders’ equity. We also use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.
- Days sales outstanding (“DSO”) – We define DSO as the average collection period for accounts receivable. It is calculated as net accounts receivable divided by the trailing four quarters’ revenues, multiplied by 365 days. We use this figure to help gauge the quality of accounts receivable and expected time to collect.

We, at times, may also refer to financial measures which are considered to be “non-GAAP financial measures” under SEC rules. We have presented these financial measures because we believe that meaningful analysis of our financial performance is enhanced by an understanding of certain additional factors underlying that performance. These financial measures should not be considered an alternative to measures required by accounting principles generally accepted in the United States. Our calculations of these measures may differ from calculations of similar measures used by other companies and you should be careful when comparing these financial measures to those of other companies. Additional information regarding these financial measures, including reconciliations of each non- GAAP financial measure, is available in the subsection of MD&A titled, "Non-GAAP Financial Measures."

Revenues – Defined

As required by Regulation S-X, we separately present revenues generated as either product revenues or service revenues on our Consolidated Statements of Income for each period presented. When we discuss revenues, we may, at times, refer to revenues summarized differently than the Regulation S-X requirements. The terminology, definitions, and applications of terms that we use to describe revenues may be different from terms used by other companies. We use the following terms to describe revenues:

- Revenues – Our revenues are presented net of sales returns and allowances.
- Product Revenues – We define product revenues as revenues generated from sales of consumable and capital equipment products.

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- Service Revenues – We define service revenues as revenues generated from parts and labor associated with the maintenance, repair, and installation of our capital equipment. Service revenues also include hospital sterilization services and instrument and scope repairs as well as revenues generated from contract sterilization and laboratory services offered through our Applied Sterilization Technologies segment. Service revenues also include linen management services operations divested in fiscal 2017.
- Capital Equipment Revenues – We define capital equipment revenues as revenues generated from sales of capital equipment, which includes steam sterilizers, low temperature liquid chemical sterilant processing systems, including SYSTEM 1 and 1E, washing systems, VHP® technology, water stills, and pure steam generators; surgical lights and tables; and integrated OR.
- Consumable Revenues – We define consumable revenues as revenues generated from sales of the consumable family of products, which includes SYSTEM 1 and 1E consumables, V-Pro consumables, gastrointestinal endoscopy accessories, sterility assurance products, skin care products, cleaning consumables, and surgical instruments.
- Recurring Revenues – We define recurring revenues as revenues generated from sales of consumable products and service revenues.

General Company Overview and Executive Summary

STERIS plc ("Parent") was organized in 2014 under the laws of England and Wales under the name Solar New HoldCo Limited as a private limited company for the purpose of effecting under the laws of England and Wales the combination ("Combination") of STERIS Corporation, an Ohio corporation ("Old STERIS"), and Synergy Health plc, a public limited company organized under the laws of England and Wales ("Synergy"). Effective November 2, 2015, the Parent was re-registered as a public company under the name of STERIS plc and the Combination closed. As a result of the Combination closing, STERIS plc became the ultimate parent company of Old STERIS and Synergy. Synergy has been re-registered under the name of Synergy Health Limited.

Our mission is to help our Customers create a healthier and safer world by providing innovative healthcare and life science product and service solutions around the globe. Our dedicated employees around the world work together to supply a broad range of solutions by offering a combination of consumables, services and capital equipment to healthcare, pharmaceutical, and medical device Customers.

We operate and report our financial information in four reportable business segments: Healthcare Products, Healthcare Specialty Services, Life Sciences, and Applied Sterilization Technologies. We describe our business segments in Note 9 to our consolidated financial statements, titled "Business Segment Information."

The bulk of our revenues are derived from the healthcare and pharmaceutical industries. Much of the growth in these industries is driven by the aging of the population throughout the world, as an increasing number of individuals are entering their prime healthcare consumption years, and is dependent upon advancement in healthcare delivery, acceptance of new technologies, government policies, and general economic conditions. The pharmaceutical industry has been impacted by increased FDA scrutiny of cleaning and validation processes, mandating that manufacturers improve their processes. Within healthcare, there is increased concern regarding the level of hospital acquired infections around the world; increased demand for medical procedures, including preventive screenings such as endoscopies and colonoscopies; and a desire by our Customers to operate more efficiently, all which are driving increased demand for many of our products and services.

We are actively pursuing new opportunities to adapt our proven technologies to meet the changing needs of the global marketplace. We are also executing on our strategic initiatives by expanding into adjacent markets with acquisitions, divesting non-core assets and integrating Synergy.

During fiscal 2017, we purchased Medisafe Holdings Ltd., a United Kingdom manufacturer of washer/disinfector equipment and related consumables and services. The purchase provides washer manufacturing and research and development capabilities in the U.K. We also completed several other minor purchases in fiscal 2018 and 2017 that expand our product and service offerings to our Customers.

During the first nine months of fiscal 2018, we divested our Synergy Health Healthcare Consumable Solutions ("HCS") business with annual revenues of approximately $40 million. During the first nine months of fiscal 2017, we divested our Applied Infection Control ("AIC") product line (annual revenues of approximately $50 million) and three businesses acquired in the Combination with Synergy consisting of: the UK Linen Management Services business (annual revenues of approximately $50 million), US Linen Management Services business (annual revenues of approximately $50 million), and Synergy Health Laboratory Services (annual revenues of approximately $15 million).

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U.S. Tax Reform. On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “TCJA”). The TCJA makes broad and complex changes to the U.S. tax code that will affect the Company’s fiscal year ending March 31, 2018, including, but not limited to, (1) requiring a one-time transition tax on certain unrepatriated earnings of non-U.S. subsidiaries which is payable over eight years, (2) bonus depreciation that will allow for full expensing of qualified property and (3) reduction of the U.S. federal corporate tax rate. The TCJA reduces the federal corporate income tax rate to 21.0 percent beginning January 1, 2018. Section 15 of the Internal Revenue Code stipulates that our fiscal year ending March 31, 2018, will have a U.S. blended corporate income tax rate of approximately 31.5 percent, which is based on the applicable tax rates before and after the TCJA and the number of days in the fiscal year.

The TCJA also establishes new tax laws that may affect the Company’s fiscal year 2019 and forward, including, but not limited to, (1) reduction of the U.S. federal corporate income tax rate as noted above; (2) elimination of the corporate alternative minimum tax (AMT); (3) the creation of the base erosion anti-abuse tax (BEAT), a new minimum tax; (4) a general elimination of U.S. federal income taxes on dividends from non-U.S. subsidiaries; (5) a new provision designed to tax global intangible low-taxed income (GILTI), which allows for the possibility of using foreign tax credits ("FTCs") and a deduction of up to 50 percent to offset the income tax liability (subject to some limitations); (6) a new limitation on deductible interest expense; (7) the repeal of the domestic production activity deduction; (8) limitations on the deductibility of certain executive compensation; (9) limitations on the use of FTCs to reduce the U.S. income tax liability; and (10) limitations on net operating losses (NOLs) generated after December 31, 2017, to 80.0 percent of taxable income.

Highlights. Revenues for the third quarter of fiscal 2018 were $661.9 million, representing an increase of 2.3% over the third quarter of fiscal 2017 revenues of $646.8 million. The fiscal 2018 increase is primarily attributable to organic revenue growth and the positive impact of currencies, which was offset by the negative impact of the recent divestitures. Revenues for the first nine months of fiscal 2018 were $1,904.0 million, representing a decrease of 1.4% over the revenues for the first nine months of fiscal 2017 of $1,931.6 million. The fiscal 2018 decrease was primarily attributable to the recent divestitures, which more than offset organic revenue growth within all business segments, the favorable impact of our recent acquisitions and the positive impact of fluctuations in currencies.

Gross margin percentage for the third quarter of fiscal 2018 was 42.1% compared with 39.8% for the third quarter of fiscal 2017. Gross margin percentage for the first nine months of fiscal 2018 was 42.1% compared with 38.6% for the first nine months of fiscal 2017. The fiscal 2018 gross margin percentage increases over the prior year periods were primarily due to the favorable impact of the divestitures of lower margin operations, favorable mix and pricing, which were slightly offset by the negative impact of fluctuations in currencies.

Operating income during the third quarter of fiscal 2018 was $104.2 million compared to $25.9 million for the third quarter of fiscal 2017. Operating income during the first nine months of fiscal 2018 was $289.8 million, compared to $169.0 million for the first nine months of fiscal 2017. The fiscal 2017 periods include the goodwill impairment loss of $58.4 million relative to the Synergy Health Netherlands linen management unit recorded in the third quarter of fiscal 2017 and a more significant net loss recognized on the divestitures of certain non-core assets. In addition to these prior year charges, the fiscal 2018 increases over the prior year periods were also attributable to margin improvements, and lower acquisition related expenses.

Cash flows from operations were $327.9 million and free cash flow was $216.4 million in the first nine months of fiscal 2018 compared to cash flows from operations of $289.4 million and free cash flow of $182.0 million in the first nine months of fiscal 2017 (see the subsection below titled "Non-GAAP Financial Measures" for additional information and related reconciliation of cash flows from operations to free cash flow). The fiscal 2018 increases in cash flows from operations and free cash flow were primarily due to higher earnings and lower requirements to fund operating assets and liabilities.

Our debt-to-total capital ratio was 31.4% at December 31, 2017 and 34.6% at March 31, 2017. During the first nine months of fiscal 2018, we declared and paid quarterly cash dividends of $0.90 per ordinary share.

Additional information regarding our financial performance during the third quarter and first nine months of fiscal 2018 is included in the subsection below titled “Results of Operations.”

NON-GAAP FINANCIAL MEASURES

We, at times, refer to financial measures which are considered to be “non-GAAP financial measures” under SEC rules. We, at times, also refer to our results of operations excluding certain transactions or amounts that are non-recurring or are not indicative of future results, in order to provide meaningful comparisons between the periods presented. These non-GAAP financial measures are not intended to be, and should not be, considered separately from or as an alternative to the most directly comparable GAAP financial measures.

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These non-GAAP financial measures are presented with the intent of providing greater transparency to supplemental financial information used by management and the Board of Directors in their financial analysis and operational decision-making. These amounts are disclosed so that the reader has the same financial data that management uses with the belief that it will assist investors and other readers in making comparisons to our historical operating results and analyzing the underlying performance of our operations for the periods presented.
We believe that the presentation of these non-GAAP financial measures, when considered along with our GAAP financial measures and the reconciliation to the corresponding GAAP financial measures, provide the reader with a more complete understanding of the factors and trends affecting our business than could be obtained absent this disclosure. It is important for the reader to note that the non-GAAP financial measure used may be calculated differently from, and therefore may not be comparable to, a similarly titled measure used by other companies.
We define free cash flow as net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows less purchases of property, plant, equipment, and intangibles plus proceeds from the sale of property, plant, equipment, and intangibles, which are also presented within investing activities in the Consolidated Statements of Cash Flows. We use this as a measure to gauge our ability to fund future debt principal repayments and growth outside of core operations, repurchase shares, and pay cash dividends.
The following table summarizes the calculation of our free cash flow for the nine months ended December 31, 2017 and 2016:

	Nine Months Ended December 31,	
(dollars in thousands)	2017	2016
Net cash provided by operating activities	$327,855	$289,405
Purchases of property, plant, equipment and intangibles, net	(113,511)	(112,225)
Proceeds from the sale of property, plant, equipment and intangibles	2,094	4,785
Free cash flow	$216,438	$181,965

Results of Operations
In the following subsections, we discuss our earnings and the factors affecting them for the third quarter and first nine months of fiscal 2018 compared with the same fiscal 2017 periods. We begin with a general overview of our operating results and then separately discuss earnings for our operating segments.

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Revenues. The following tables compare our revenues for the three and nine months ended December 31, 2017 to the revenues for the three and nine months ended December 31, 2016:

	Three Months Ended December 31,			
(dollars in thousands)	2017	2016	Change	Percent Change
Total revenues	$661,900	$646,774	$15,126	2.3 %
Revenues by type:				
Service revenues	352,439	344,514	7,925	2.3 %
Consumable revenues	147,516	134,117	13,399	10.0 %
Capital equipment revenues	161,945	168,143	(6,198)	(3.7)%
Revenues by geography:				
United Kingdom revenues	50,902	52,316	(1,414)	(2.7)%
United States revenues	465,228	447,573	17,655	3.9 %
Other foreign revenues	145,770	146,885	(1,115)	(0.8)%

	Nine Months Ended December 31,			
(dollars in thousands)	2017	2016	Change	Percent Change
Total revenues	$1,904,023	$1,931,567	$(27,544)	(1.4)%
Revenues by type:				
Service revenues	1,034,400	1,065,341	(30,941)	(2.9)%
Consumable revenues	436,619	419,358	17,261	4.1 %
Capital equipment revenues	433,004	446,868	(13,864)	(3.1)%
Revenues by geography:				
United Kingdom revenues	158,211	176,124	(17,913)	(10.2)%
United States revenues	1,334,895	1,326,190	8,705	0.7 %
Other foreign revenues	410,917	429,253	(18,336)	(4.3)%

Quarter over Quarter Comparison

Revenues increased $15.1 million, or 2.3%, to $661.9 million for the three months ended December 31, 2017, as compared to $646.8 million for the same period in the prior year. This increase was primarily attributable to organic growth and the positive impact of currencies, which was offset by the negative impact of our recent divestitures.

Consumable revenues increased 10.0% in the third quarter of fiscal 2018 as compared to third quarter of fiscal 2017, reflecting growth within the Healthcare Products and Life Sciences business segments. Service revenues increased by 2.3%, as increases in other service offerings more than offset the impact of divestitures. Capital equipment revenues decreased 3.7%, as growth in the Life Sciences business segment was offset by a decline in the Healthcare Products segment.

United Kingdom revenues slightly decreased $1.4 million, or 2.7%, to $50.9 million for the three months ended December 31, 2017, as compared to $52.3 million for the same period in the prior year. This decrease was primarily due to declines in capital equipment, consumable and product revenues as we divested HCS in the third quarter of fiscal 2018.

United States revenues increased $17.7 million, or 3.9%, to $465.2 million for the three months ended December 31, 2017, as compared to $447.6 million for the same period in the prior year. Strength in service offerings, Healthcare Products consumable revenues, and Life Sciences capital equipment and consumable revenues more than offset the impact of the fiscal 2017 divestitures and a decline in Healthcare Products capital equipment revenues.

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Revenues from other foreign locations decreased $1.1 million, or 0.8%, to $145.8 million for the three months ended December 31, 2017, as compared to $146.9 million for the same period in the prior year, primarily due to the fiscal 2017 divestiture of Netherlands Linen Management Services and a decline in Healthcare Products capital equipment revenues in Canada which more than offset growth within the Latin American region.

First Nine Months over First Nine Months Comparison

Revenues decreased $27.5 million, or 1.4%, to $1,904.0 million for the nine months ended December 31, 2017, as compared to $1,931.6 million for the same period in the prior year. This decrease was primarily attributable to the recent divestitures, which more than offset organic revenue growth within all business segments, the favorable impact of our recent acquisitions and the positive impact of fluctuations in currencies.

Consumable revenues increased 4.1% in the first nine months of fiscal 2018 compared to the first nine months of fiscal 2017, reflecting growth within the Healthcare Products and Life Sciences business segments which more than offset the impact of the divestiture of the AIC product line and HCS within the Healthcare Products segment. Capital equipment revenues decreased 3.1%, reflecting a decline within the Healthcare Products business segment which was offset by growth within the Healthcare Specialty Services and Life Sciences business segments. Service revenues decreased 2.9% in the first nine months of fiscal 2018, as compared to the same period in fiscal 2017, as the impact of divestitures more than offset increases in other service offerings.

United Kingdom revenues decreased $17.9 million, or 10.2%, to $158.2 million for the nine months ended December 31, 2017, as compared to $176.1 million for the same period in the prior year, reflecting decline in service revenues, primarily resulting from our fiscal 2017 divestitures of Synergy Health Laboratory Services and Synergy Health UK Linen Management Services.

United States revenues increased $8.7 million, or 0.7%, to $1,334.9 million for the nine months ended December 31, 2017, as compared to $1,326.2 million for the same period in the prior year, as strength in Life Sciences capital equipment, consumable revenues and service offerings within all business segments more than offset the impact of the fiscal 2017 divestitures and a decline in Healthcare Products capital equipment revenues.

Revenues from other foreign locations decreased $18.3 million, or 4.3%, to $410.9 million for the nine months ended December 31, 2017, as compared to $429.3 million in the nine months ended December 31, 2016, primarily due to the divestiture of Netherlands Linen Management Services, which more than offset growth in Canada and in the Asia Pacific and Latin America regions.

Gross Profit. The following table compares our gross profit for the three and nine months ended December 31, 2017 to the three and nine months ended December 31, 2016:

(dollars in thousands)	Three Months Ended December 31, 2017	2016	Change	Percent Change
Gross profit:				
Product	$146,850	$149,381	$(2,531)	(1.7)%
Service	131,738	108,228	23,510	21.7 %
Total gross profit	$278,588	$257,609	$20,979	8.1 %
Gross profit percentage:				
Product	47.5 %	49.4 %		
Service	37.4 %	31.4 %		
Total gross profit percentage	42.1 %	39.8 %		

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(dollars in thousands)	Nine Months Ended December 31, 2017	2016	Change	Percent Change
Gross profit:				
Product	$411,156	$415,538	$(4,382)	(1.1)%
Service	390,314	329,969	60,345	18.3 %
Total gross profit	$801,470	$745,507	$55,963	7.5 %
Gross profit percentage:				
Product	47.3 %	48.0 %		
Service	37.7 %	31.0 %		
Total gross profit percentage	42.1 %	38.6 %		

Our gross profit is affected by the volume, pricing, and mix of sales of our products and services, as well as the costs associated with the products and services that are sold.

Gross profit percentage for the third quarter of fiscal 2018 was 42.1% compared to the gross profit percentage for the third quarter of fiscal 2017 of 39.8%. The increase in our gross profit percentage was primarily due to the favorable impact of divestitures of lower margin operations (170 basis points), favorable pricing (60 basis points) and favorable mix and other (50 basis points) which was offset by the negative impact of currencies (40 basis points) and decline in volume (10 basis points).

Gross profit percentage for the first nine months of fiscal 2018 was 42.1% compared to the gross profit percentage for the first nine months of fiscal 2017 of 38.6%. The increase in our gross profit percentage was primarily due to the favorable impact of divestitures of lower margin operations (250 basis points), favorable mix and other (80 basis points), favorable pricing (40 basis points) and our recent acquisitions (10 basis points) which was offset by the negative impact of currencies (20 basis points) and decline in volume (10 basis points).

Operating Expenses. The following table compares our operating expenses for the three and nine months ended December 31, 2017 to the three and nine months ended December 31, 2016:

(dollars in thousands)	Three Months Ended December 31, 2017	2016	Change	Percent Change
Operating expenses:				
Selling, general, and administrative	$159,143	$158,760	$383	0.2 %
Goodwill impairment loss	—	58,356	(58,356)	NM
Research and development	15,195	14,591	604	4.1 %
Restructuring expenses	78	18	60	NM
Total operating expenses	$174,416	$231,725	$(57,309)	(24.7)%

(dollars in thousands)	Nine Months Ended December 31, 2017	2016	Change	Percent Change
Operating expenses:				
Selling, general, and administrative	$468,310	$474,326	$(6,016)	(1.3)%
Goodwill impairment loss	—	58,356	(58,356)	NM
Research and development	43,173	43,636	(463)	(1.1)%
Restructuring expenses	156	220	(64)	NM
Total operating expenses	$511,639	$576,538	$(64,899)	(11.3)%

NM - Not meaningful.

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Selling, General, and Administrative Expenses. Significant components of total selling, general, and administrative expenses ("SG&A") are compensation and benefit costs, fees for professional services, travel and entertainment, facilities costs, and other general and administrative expenses. SG&A increased 0.2% during the third quarter of fiscal 2018 over the same fiscal 2017 period. The increase was primarily attributable to higher amortization expense related to purchased intangible assets and an increase in compensation expense resulting from a higher anticipated annual bonus payout percentage in the fiscal 2018 period. SG&A decreased 1.3% during the first nine months of fiscal 2018 over the same fiscal 2017 period. The decrease during the first nine months of the fiscal 2018 period over the same fiscal 2017 period was primarily attributable to lower acquisition and integration costs.

Goodwill impairment loss. Goodwill impairment loss was $58.4 million for the three and nine month periods ending December 31, 2016, as a result of our annual goodwill impairment review in the third quarter relative to the Synergy Health Netherlands linen management unit.

Research and Development. Research and development expenses increased 4.1% during the third quarter of fiscal 2018 over the same fiscal 2017 period. Research and development expenses decreased 1.1% during the first nine months of fiscal 2018 over the same fiscal 2017 period. Research and development expenses are influenced by the number and timing of in-process projects and labor hours and other costs associated with these projects. Our research and development initiatives continue to emphasize new product development, product improvements, and the development of new technological platform innovations. During the first nine months of fiscal 2018, our investments in research and development continued to be focused on, but were not limited to, enhancing capabilities of sterile processing combination technologies, procedural products and accessories, and devices and support accessories used in gastrointestinal endoscopy procedures.

Non-Operating Expenses, Net. Non-operating expenses, net consists of interest expense on debt, offset by interest earned on cash, cash equivalents, short-term investment balances, and other miscellaneous income. The following table compares our net non-operating expenses for the three and nine months ended December 31, 2017 and 2016:

	Three Months Ended December 31,		
(dollars in thousands)	2017	2016	Change
Non-operating expenses, net:			
Interest expense	$12,461	$10,980	$1,481
Interest income and miscellaneous expense	(225)	(539)	314
Non-operating expenses, net	$12,236	$10,441	$1,795

	Nine Months Ended December 31,		
(dollars in thousands)	2017	2016	Change
Non-operating expenses, net:			
Interest expense	$37,610	$32,975	$4,635