DENTSPLY INTERNATIONAL INC /DE/
Form 10-Q
August 01, 2013

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

FORM 10-Q

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

For the quarterly period ended June 30, 2013
OR

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

For the transition period from ______________ to _______________

Commission File Number 0-16211

DENTSPLY International Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	39-1434669 (I.R.S. Employer Identification No.)
221 West Philadelphia Street, York, PA (Address of principal executive offices)	17405-0872 (Zip Code)

(717) 845-7511
(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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No 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 definition of "large accelerated filer" and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: At July 24, 2013, DENTSPLY International Inc. had 142,288,292 shares of Common Stock outstanding, with a par value of $.01 per share.

DENTSPLY International Inc.

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PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

DENTSPLY INTERNATIONAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(unaudited)

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Net sales	$761,010	$762,994	$1,493,094	$1,479,407
Cost of products sold	346,054	355,525	689,938	679,188
Gross profit	414,956	407,469	803,156	800,219
Selling, general and administrative expenses	289,921	296,034	583,598	600,388
Restructuring and other costs	2,169	2,528	2,834	3,765
Operating income	122,866	108,907	216,724	196,066
Other income and expenses:				
Interest expense	11,507	14,323	26,728	30,105
Interest income	(2,243)	(1,984)	(4,418)	(3,862)
Other expense (income), net	4,223	982	7,141	1,045
Income before income taxes	109,379	95,586	187,273	168,778
Provision for income taxes	22,870	14,875	26,412	29,590
Equity in net earnings (loss) of unconsolidated affiliated company	2,182	1,329	403	(2,919)
Net income	88,691	82,040	161,264	136,269
Less: Net income attributable to noncontrolling interests	1,463	1,276	2,351	2,220
Net income attributable to DENTSPLY International	$87,228	$80,764	$158,913	$134,049
Earnings per common share:				
Basic	$0.61	$0.57	$1.11	$0.95
Diluted	$0.60	$0.56	$1.10	$0.93
Weighted average common shares outstanding:				
Basic	142,922	141,737	142,849	141,729
Diluted	145,133	143,863	145,107	143,908

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

DENTSPLY INTERNATIONAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	$88,691	$82,040	$161,264	$136,269
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	5,886	(178,746)	(88,256)	(45,275)
Net (loss) gain on derivative financial instruments	(13,362)	47,089	14,756	14,957
Net unrealized holding (loss) gain on available-for-sale securities	(16,629)	(7,954)	(8,989)	15,046
Pension liability adjustments	540	1,726	3,316	1,666
Total other comprehensive loss	(23,565)	(137,885)	(79,173)	(13,606)
Total comprehensive income (loss)	65,126	(55,845)	82,091	122,663
Less: Comprehensive income (loss) attributable to noncontrolling interests	2,019	(928)	2,200	1,356
Comprehensive income (loss) attributable to DENTSPLY International	$63,107	$(54,917)	$79,891	$121,307

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

DENTSPLY INTERNATIONAL INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current Assets:		
Cash and cash equivalents	$57,027	$80,132
Accounts and notes receivables-trade, net	499,006	442,412
Inventories, net	433,189	402,940
Prepaid expenses and other current assets	180,811	185,612
Total Current Assets	1,170,033	1,111,096
Property, plant and equipment, net	605,028	614,705
Identifiable intangible assets, net	786,667	830,642
Goodwill, net	2,158,529	2,210,953
Other noncurrent assets, net	154,426	204,901
Total Assets	$4,874,683	$4,972,297
Liabilities and Equity		
Current Liabilities:		
Accounts payable	$147,455	$165,290
Accrued liabilities	308,148	424,336
Income taxes payable	17,947	39,191
Notes payable and current portion of long-term debt	417,065	298,963
Total Current Liabilities	890,615	927,780
Long-term debt	1,123,792	1,222,035
Deferred income taxes	218,624	232,641
Other noncurrent liabilities	353,556	340,398
Total Liabilities	2,586,587	2,722,854
Commitments and contingencies		
Equity:		
Preferred stock, $.01 par value; .25 million shares authorized; no shares issued	—	—
Common stock, $.01 par value; 200.0 million shares authorized; 162.8 million shares issued at June 30, 2013 and December 31, 2012.	1,628	1,628
Capital in excess of par value	244,598	246,548
Retained earnings	2,959,391	2,818,461
Accumulated other comprehensive loss	(223,222)	(144,200)
Treasury stock, at cost, 20.6 million and 20.5 million shares at June 30, 2013 and December 31, 2012, respectively.	(732,210)	(713,739)

Total DENTSPLY International Equity	2,250,185	2,208,698
Noncontrolling interests	37,911	40,745
Total Equity	2,288,096	2,249,443
Total Liabilities and Equity	$4,874,683	$4,972,297

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

DENTSPLY INTERNATIONAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$161,264	$136,269
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	41,743	40,357
Amortization	23,434	28,014
Amortization of deferred financing costs	2,592	2,391
Deferred income taxes	(8,564)	(4,432)
Share-based compensation expense	12,023	11,029
Restructuring and other costs - noncash	1,570	2,105
Stock option income tax benefit	(1,122)	(5,163)
Equity in (earnings) loss from unconsolidated affiliates	(403)	2,919
Other non-cash expense (income)	11,480	(3,102)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts and notes receivable-trade, net	(72,324)	(41,461)
Inventories, net	(40,700)	(47,034)
Prepaid expenses and other current assets	26,364	(19,455)
Other noncurrent assets, net	845	(3,497)
Accounts payable	(11,143)	(1,320)
Accrued liabilities	(3,621)	(3,244)
Income taxes	(17,670)	5,423
Other noncurrent liabilities	6,100	3,596
Net cash provided by operating activities	131,868	103,395
Cash flows from investing activities:		
Capital expenditures	(46,151)	(42,986)
Cash paid for acquisitions of businesses, net of cash acquired	(3,939)	—
Cash received on derivatives	7,499	—
Cash paid on derivatives	(94,843)	(14,221)
Expenditures for identifiable intangible assets	(963)	(188)
Purchase of Company-owned life insurance policies	—	(1,577)
Proceeds from sale of property, plant and equipment, net	2,209	465
Net cash used in investing activities	(136,188)	(58,507)
Cash flows from financing activities:		
Net change in short-term borrowings	40,450	(35,181)
Cash paid for treasury stock	(62,278)	(38,840)

Cash dividends paid	(16,928)	(15,706)
Cash paid for contingent consideration on prior acquisitions	—	(1,781)
Cash paid for acquisition of noncontrolling interests of consolidated subsidiary	(8,960)	—
Proceeds from exercise of stock options	31,213	20,066
Excess tax benefits from share-based compensation	1,122	5,163
Cash received on derivative contracts	25	—
Cash paid on derivative contracts	(80)	(1,135)
Net cash used in financing activities	(15,436)	(67,414)
Effect of exchange rate changes on cash and cash equivalents	(3,349)	(1,392)
Net decrease in cash and cash equivalents	(23,105)	(23,918)
Cash and cash equivalents at beginning of period	80,132	77,128
Cash and cash equivalents at end of period	$57,027	$53,210

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

DENTSPLY INTERNATIONAL INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(In thousands)
(unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total DENTSPLY International Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2011	$1,628	$229,687	$2,535,709	$(190,970)	$(727,977)	$1,848,077	$36,074	$1,884,151
Net income	—	—	134,049	—	—	134,049	2,220	136,269
Other comprehensive loss	—	—	—	(12,742)	—	(12,742)	(864)	(13,606)
Exercise of stock options	—	(7,158)	—	—	27,224	20,066	—	20,066
Tax benefit from stock options exercised	—	5,163	—	—	—	5,163	—	5,163
Share based compensation expense	—	11,029	—	—	—	11,029	—	11,029
Funding of Employee Stock Ownership Plan	—	370	—	—	3,272	3,642	—	3,642
Treasury shares purchased	—	—	—	—	(38,840)	(38,840)	—	(38,840)
RSU distributions	—	(8,344)	—	—	5,068	(3,276)	—	(3,276)
RSU dividends	—	115	(115)	—	—	—	—	—
Cash dividends ($0.110 per share)	—	—	(15,599)	—	—	(15,599)	—	(15,599)
Balance at June 30, 2012	$1,628	$230,862	$2,654,044	$(203,712)	$(731,253)	$1,951,569	$37,430	$1,988,999

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total DENTSPLY International Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2012	$1,628	$246,548	$2,818,461	$(144,200)	$(713,739)	$2,208,698	$40,745	$2,249,443

Net income	—	—	158,913	—	—	158,913	2,351	161,264
Other comprehensive loss	—	—	—	(79,022)	—	(79,022)	(151)	(79,173)
Acquisition of noncontrolling interest	—	(3,926)	—	—	—	(3,926)	(5,034)	(8,960)
Exercise of stock options	—	(3,937)	—	—	35,150	31,213	—	31,213
Tax benefit from stock options exercised	—	1,122	—	—	—	1,122	—	1,122
Share based compensation expense	—	12,023	—	—	—	12,023	—	12,023
Funding of Employee Stock Ownership Plan	—	959	—	—	3,698	4,657	—	4,657
Treasury shares purchased	—	—	—	—	(62,278)	(62,278)	—	(62,278)
RSU distributions	—	(8,342)	—	—	4,959	(3,383)	—	(3,383)
RSU dividends	—	151	(151)	—	—	—	—	—
Cash dividends ($0.125 per share)	—	—	(17,832)	—	—	(17,832)	—	(17,832)
Balance at June 30, 2013	$1,628	$244,598	$2,959,391	$(223,222)	$(732,210)	$ 2,250,185	$ 37,911	$2,288,096

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

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DENTSPLY International Inc. and Subsidiaries

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and the rules of the United States Securities and Exchange Commission ("SEC"). The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by US GAAP. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for interim periods have been included. Results for interim periods should not be considered indicative of results for a full year. These financial statements and related notes contain the accounts of DENTSPLY International Inc. and Subsidiaries ("DENTSPLY" or the "Company") on a consolidated basis and should be read in conjunction with the consolidated financial statements and notes included in the Company's most recent Form 10-K for the year ended December 31, 2012.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company, as applied in the interim consolidated financial statements presented herein are substantially the same as presented in the Company's Form 10-K for the year ended December 31, 2012, except as may be indicated below:

Accounts and Notes Receivable

The Company sells dental and certain healthcare products through a worldwide network of distributors and directly to end users. For customers on credit terms, the Company performs ongoing credit evaluations of those customers' financial condition and generally does not require collateral from them. The Company establishes allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments based on historical averages of aged receivable balances and the Company's experience in collecting those balances, customer specific circumstances, as well as changes in the economic and political environments. The Company records a provision for doubtful accounts, which is included in "Selling, general and administrative expenses."

Accounts and notes receivables – trade, net are stated net of allowances for doubtful accounts and trade discounts, which was $15.2 million at June 30, 2013 and $14.5 million at December 31, 2012.

Marketable Securities

The Company's marketable securities consist of corporate convertible bonds that are classified as available-for-sale in "Other noncurrent assets, net" on the Consolidated Balance Sheets as the instruments mature in December 2015. The Company determined the appropriate classification at the time of purchase and will re-evaluate such designation as of each balance sheet date. In addition, the Company reviews the securities each quarter for indications of possible impairment. If an impairment is identified, the determination of whether the impairment is temporary or other-than-temporary requires significant judgment. The primary factors that the Company considers in making this judgment include the extent and time the fair value of each investment has been below cost and the existence of a credit loss. If a decline in fair value is judged other-than-temporary, the basis of the securities is written down to fair value and the amount of the write-down is included as a realized loss in the consolidated statement of operations. Changes in fair value are reported in accumulated other comprehensive income ("AOCI").

The convertible feature of the bonds has not been bifurcated from the underlying bonds as the feature does not contain a net-settlement feature, nor would the Company be able to achieve a hypothetical net-settlement that would substantially place the Company in a comparable cash settlement position. As such, the derivative is not accounted for separately from the bond. The cash paid by the Company was equal to the face value of the bonds issued, and therefore, the Company has not recorded any bond premium or discount on acquiring the bonds. The fair value of the bonds was $61.6 million and $75.1 million at June 30, 2013 and December 31, 2012, respectively. At June 30, 2013 and December 31, 2012, an unrealized holding gain of $8.8 million and $17.8 million, respectively, on available-for-sale securities, net of tax, had been recorded in AOCI.

New Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities." The standard requires entities to disclose both gross and net information about instruments and transactions that are offset in the Consolidated Balance Sheet, as well as instruments and transactions that are subject to an enforceable master netting agreement or similar agreement. In January

2013, The FASB issued ASU No. 2013-01, “Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities.” The standard clarifies the scope of the disclosure to apply only to derivatives, including bifurcated embedded derivatives, repurchase and reverse repurchase agreements as well as securities lending and borrowing transactions. The standard was effective January 1, 2013, with retrospective application required. The adoption of this standard did not have a material impact to the Company’s financial statements. The Company adopted this accounting standard during the quarter ended March 31, 2013.

In July 2012, the FASB issued ASU No. 2012-02, “Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment.” This newly issued accounting standard is intended to reduce the cost and complexity of the annual indefinite-lived intangible asset impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. Under the revised standard, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step impairment test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that an indefinite-lived intangible asset is less than its carrying amount, the quantitative impairment test is required; otherwise, no further testing is required. Prior to the issuance of the revised standard, an entity was required to perform step one of the impairment test at least annually by calculating and comparing the fair value of an indefinite-lived intangible asset to its carrying amount. Under the revised standard, if an entity determines that step one is necessary and the indefinite-lived intangible asset is less than its carrying amount, then step two of the test will continue to be required to measure the amount of the impairment loss, if any. This ASU is effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of this standard did not materially impact the Company’s financial position or results of operations. The Company adopted this accounting standard during the quarter ended March 31, 2013.

In February 2013, the FASB issued ASU No. 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” This newly issued accounting standard requires an entity to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income in its entirety in the same period. For other amounts not required to be reclassified to net income in the same reporting period, a cross reference to other disclosures that provide additional detail about the reclassification amounts is required. Since the standard only impacts the disclosure requirements of AOCI and does not impact the accounting for accumulated comprehensive income, the standard did not have an impact on the Company’s consolidated financial statements. The Company adopted this accounting standard during the quarter ended March 31, 2013.

In March 2013, the FASB issued ASU No. 2013-05, “Foreign Currency Matters (Topic 830): Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity.” This newly issued accounting standard requires a cumulative translation adjustment (“CTA”)attached to the parent’s investment in a foreign entity should be released in a manner consistent with the derecognition guidance on investment entities. Thus the entire amount of CTA associated with the foreign entity would be released when there has been a sale of a subsidiary or group of net assets within a foreign entity and the sale represents a complete liquidation of the investment in the foreign entity, a loss of a controlling financial interest in an investment in a foreign entity, or step acquisition for a foreign entity. The adoption of this standard will not materially impact the Company’s financial position or results of operations. The Company expects to adopt this accounting standard for the quarter ending March 31, 2014.

NOTE 2 – STOCK COMPENSATION

The following table represents total stock based compensation expense for non-qualified stock options, restricted stock units (“RSU”) and the tax related benefit for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended		Six Months Ended	
(in thousands)	2013	2012	2013	2012
Stock option expense	$2,876	$3,298	$5,005	$5,679
RSU expense	3,337	3,094	5,560	4,640
Total stock based compensation expense	$6,213	$6,392	$10,565	$10,319
Total related tax benefit	$1,788	$1,916	$2,865	$2,935

At June 30, 2013, the remaining unamortized compensation cost related to non-qualified stock options is $15.6 million, which will be expensed over the weighted average remaining vesting period of the options, or 1.7 years. At June 30, 2013, the unamortized compensation cost related to RSU is $26.3 million, which will be expensed over the remaining restricted period of the RSU, or 1.7 years.

The following table reflects the non-qualified stock option transactions from December 31, 2012 through June 30, 2013:

	Outstanding			Exercisable		
(in thousands, except per share data)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balance at December 31, 2012	9,906	$33.18	$69,079	7,599	$31.79	$64,819
Granted	911	40.91				
Exercised	(1,110)	28.11				
Cancelled	(13)	43.19				
Forfeited	(116)	38.76				
Balance at June 30, 2013	9,578	$34.43	$66,655	7,400	$33.05	$62,541

At June 30, 2013, the weighted average remaining contractual term of all outstanding options is 5.9 years and the weighted average remaining contractual term of exercisable options is 5.0 years.

The following table summarizes the unvested RSU transactions from December 31, 2012 through June 30, 2013:

(in thousands, except per share data)	Shares	Weighted Average Grant Date Fair Value
Balance at December 31, 2012	1,034	$36.34
Granted	499	40.89
Vested	(236)	32.57
Forfeited	(120)	38.75
Balance at June 30, 2013	1,177	$38.78

NOTE 3 – COMPREHENSIVE INCOME

During the quarter ended June 30, 2013, foreign currency translation adjustments included currency translation gains of $1.3 million and gains on the Company’s loans designated as hedges of net investments of $4.0 million. During the quarter ended June 30, 2012, foreign currency translation adjustments included currency translation losses of $175.3 million and losses of $1.2 million on the Company’s loans designated as hedges of net investments. During the six months ended June 30, 2013, foreign currency translation adjustments included currency losses of $100.6 million and gains on the Company’s loans designated as hedges of net investments of $12.5 million. During the six months ended June 30, 2012, foreign currency translation adjustments included currency translation losses of $48.5 million and gains on the Company’s loans designated as hedges of net investments of $4.1 million. These foreign currency translation adjustments were offset by movements on derivative financial instruments, which are discussed in Note 10, Financial Instruments and Derivatives.

The cumulative foreign currency translation adjustments included translation gains of $77.1 million and $177.7 million at June 30, 2013 and December 31, 2012, respectively, were offset by losses of $110.9 million and $123.4 million, respectively, on loans designated as hedges of net investments. These foreign currency translation adjustments were partially offset by movements on derivatives financial instruments, which are discussed in Note 10, Financial Instruments and Derivatives.

Changes in AOCI, net of tax, by component for the six months ended June 30, 2013 and 2012:

(in thousands)	Foreign Currency Translation Adjustments	Gains and (Loss) on Derivative Financial Instruments	Net Unrealized Holding Gain on Available-for-Sale Securities	Pension Liability Adjustments	Total
Balance at December 31, 2012	$54,302	$(143,142)	$ 17,822	$(73,182)	$(144,200)
Other comprehensive (loss) income before reclassifications	(88,105)	14,553	(8,989)	1,439	(81,102)
Amounts reclassified from accumulated other comprehensive income (loss)	—	203	—	1,877	2,080
Net (decrease) increase in other comprehensive income	(88,105)	14,756	(8,989)	3,316	(79,022)
Balance at June 30, 2013	$(33,803)	$(128,386)	$ 8,833	$(69,866)	$(223,222)

(in thousands)	Foreign Currency Translation Adjustments	Gains and (Loss) on Derivative Financial Instruments	Net Unrealized Holding (Loss) Gain on Available-for-Sale Securities	Pension Liability Adjustments	Total
Balance at December 31, 2011	$(39,078)	$(117,390)	$ (516)	$(33,986)	$(190,970