ICU MEDICAL INC/DE
Form 10-Q
November 09, 2018

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: September 30, 2018
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 No.: 001-34634
ICU MEDICAL, INC.
(Exact name of Registrant as specified in its charter)

Delaware	33-0022692
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
951 Calle Amanecer, San Clemente, California	92673
(Address of principal executive offices)	(Zip Code)

(949) 366-2183
(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, if any, every Interactive Data File required to be submitted and posted 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 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 (check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at October 31, 2018
Common	20,489,181

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

ICU MEDICAL, INC. AND SUBSIDIARIES
Form 10-Q
September 30, 2018

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PART I - FINANCIAL INFORMATION
Item1. Financial Statements (Unaudited)

ICU MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value data)

	September 30, 2018 (Unaudited)	December 31, 2017 (1)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 318,816	$ 290,072
Short-term investment securities	36,960	10,061
TOTAL CASH, CASH EQUIVALENTS AND INVESTMENT SECURITIES	355,776	300,133
Accounts receivable, net of allowance for doubtful accounts of $5,088 at September 30, 2018 and $3,311 at December 31, 2017	144,535	112,696
Inventories	291,840	288,657
Prepaid income tax	24,447	10,594
Prepaid expenses and other current assets	26,306	41,286
Related-party receivable	70,408	98,807
Assets held-for-sale	—	12,489
TOTAL CURRENT ASSETS	913,312	864,662
PROPERTY AND EQUIPMENT, net	424,897	398,684
LONG-TERM INVESTMENT SECURITIES	2,922	14,579
GOODWILL	13,199	12,357
INTANGIBLE ASSETS, net	131,811	143,753
DEFERRED INCOME TAXES	20,341	24,775
OTHER ASSETS	38,693	38,141
TOTAL ASSETS	$ 1,545,175	$ 1,496,951
LIABILITIES AND STOCKHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 70,566	$ 78,228
Accrued liabilities	131,954	132,064
TOTAL CURRENT LIABILITIES	202,520	210,292
CONTINGENT EARN-OUT LIABILITY	47,500	27,000
OTHER LONG-TERM LIABILITIES	29,057	55,326
DEFERRED INCOME TAXES	1,193	1,487
INCOME TAX LIABILITY	4,592	4,592
COMMITMENTS AND CONTINGENCIES	—	—
STOCKHOLDERS’ EQUITY:		
Convertible preferred stock, $1.00 par value Authorized—500 shares; Issued and outstanding— none	—	—
Common stock, $0.10 par value — Authorized, 80,000 shares; Issued and outstanding, 20,489 shares at September 30, 2018 and 20,210 shares at December 31, 2017	2,049	2,021
Additional paid-in capital	651,752	625,568
Treasury stock, at cost	(128)	—
Retained earnings	628,101	585,624

Accumulated other comprehensive loss	(21,461)	(14,959)
TOTAL STOCKHOLDERS' EQUITY	1,260,313	1,198,254
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,545,175	$ 1,496,951

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(1) December 31, 2017 balances were derived from audited consolidated financial statements.
The accompanying notes are an integral part of these condensed consolidated financial statements.

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ICU MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
REVENUE:				
Net sales	$327,169	$343,084	$1,059,662	$921,544
Other	—	152	—	945
TOTAL REVENUE	327,169	343,236	1,059,662	922,489
COST OF GOODS SOLD	192,582	231,638	624,274	633,884
GROSS PROFIT	134,587	111,598	435,388	288,605
OPERATING EXPENSES:				
Selling, general and administrative	78,068	76,820	248,603	226,812
Research and development	13,181	12,769	39,342	37,377
Restructuring, strategic transaction and integration	24,012	18,711	64,271	68,033
Change in fair value of contingent earn-out	18,500	7,000	20,500	13,000
Contract settlement	—	—	28,917	—
TOTAL OPERATING EXPENSES	133,761	115,300	401,633	345,222
INCOME (LOSS) FROM OPERATIONS	826	(3,702)	33,755	(56,617)
BARGAIN PURCHASE GAIN	—	8,534	—	71,771
INTEREST EXPENSE	(283)	(705)	(548)	(1,743)
OTHER INCOME (EXPENSE)	894	583	1,650	(2,030)
INCOME BEFORE INCOME TAXES	1,437	4,710	34,857	11,381
(PROVISION) BENEFIT FOR INCOME TAXES	(1,218)	(4,574)	1,291	7,558
NET INCOME	$219	$136	$36,148	$18,939
NET INCOME PER SHARE				
Basic	$0.01	$0.01	$1.78	$0.97
Diluted	$0.01	$0.01	$1.67	$0.92
WEIGHTED AVERAGE NUMBER OF SHARES				
Basic	20,474	19,984	20,362	19,433
Diluted	21,633	21,106	21,588	20,603

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

ICU MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (Unaudited)
(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
NET INCOME	$219	$136	$36,148	$18,939
Other comprehensive income (loss), net of tax:				
Cash flow hedge adjustments, net of taxes of $(372) and $82 for the three months ended September 30, 2018 and 2017 and $(376) and $(603) for the nine months ended September 30, 2018 and 2017, respectively	1,178	(134)	1,192	985
Foreign currency translation adjustment, net of taxes of $0 for the three months ended September 30, 2018 and 2017, and $0 and $56 for the nine months ended September 30, 2018 and 2017, respectively	(5,415)	5,833	(7,705)	16,747
Other adjustments, net of taxes of $0 for all periods	6	(90)	11	(238)
Other comprehensive (loss) income, net of taxes	(4,231)	5,609	(6,502)	17,494
TOTAL COMPREHENSIVE (LOSS) INCOME	$(4,012)	$5,745	$29,646	$36,433

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

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ICU MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Nine months ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$36,148	$18,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	55,069	47,512
Provision for doubtful accounts	638	1,906
Provision for warranty and returns	1,817	3,639
Stock compensation	17,992	13,387
Loss on disposal of property and equipment	760	3,177
Bond premium amortization	313	12
Debt issuance costs amortization	216	—
Bargain purchase gain	—	(71,771)
Change in fair value of contingent earn-out	20,500	13,000
Impairment of assets held for sale	269	—
Write-off of acquired intangible	5,000	—
Other	2,100	1,690
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(38,957)	(51,498)
Inventories	12,201	148,482
Prepaid expenses and other assets	(1,826)	6,214
Related-party receivables	31,004	(131,617)
Accounts payable	(2,094)	17,551
Accrued liabilities	(18,509)	63,234
Income taxes, including excess tax benefits and deferred income taxes	(12,359)	(13,982)
Net cash provided by operating activities	110,282	69,875
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(75,057)	(51,702)
Proceeds from sale of asset	13,000	2
Business acquisitions, net of cash acquired	(1,300)	(157,097)
Intangible asset additions	(5,375)	(3,718)
Purchases of investment securities	(30,495)	(24,743)
Proceeds from sale of investment securities	14,940	—
Net cash used in investing activities	(84,287)	(237,258)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	14,211	19,967
Proceeds from employee stock purchase plan	—	2,705
Tax withholding payments related to net share settlement of equity awards	(6,119)	(3,951)
Net cash provided by financing activities	8,092	18,721
Effect of exchange rate changes on cash	(5,343)	4,194
NET INCREASE (DECREASE) CASH AND CASH EQUIVALENTS	28,744	(144,468)
CASH AND CASH EQUIVALENTS, beginning of period	290,072	445,082
CASH AND CASH EQUIVALENTS, end of period	$318,816	$300,614

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

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ICU MEDICAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED
(In thousands)

	Nine months ended September 30,	
	2018	2017
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES:		
Accounts payable for property and equipment	$1,184	$1,435
Detail of acquisitions:		
Fair value of assets acquired		$893,582
Cash paid for acquisitions, net of cash acquired		(157,097)
Non-cash seller note		(75,000)
Estimated working capital adjustment		7,512
Contingent consideration		(19,000)
Issuance of common stock		(413,139)
Bargain purchase gain		(71,771)
Goodwill		1,015
Liabilities assumed		$166,102

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

ICU MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S.") and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and reflect all adjustments, consisting of only normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of the consolidated results for the interim periods presented. Results for the interim period are not necessarily indicative of results for the full year. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K of ICU Medical, Inc., ("ICU") a Delaware corporation, filed with the SEC for the year ended December 31, 2017.

We are engaged in the development, manufacturing and sale of innovative medical products used in infusion therapy, and critical care markets. We sell the majority of our products through our direct sales force and through independent distributors throughout the U. S. and internationally. Additionally, we sell our products on an original equipment manufacturer basis to other medical device manufacturers. All subsidiaries are wholly owned and are included in the condensed consolidated financial statements. All intercompany balances and transactions have been eliminated.

Note 2: New Accounting Pronouncements

Recently Adopted Accounting Standards

In March 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. This update adds SEC paragraphs pursuant to the SEC Staff Accounting Bulletin No. 118, which expresses the view of the staff regarding application of Topic 740, Income Taxes, in the reporting period that includes December 22, 2017 - the date on which the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. We adopted this ASU in the prior year and it did not have a material impact on our consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendments in this update change both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results to facilitate financial reporting that more closely reflects an entity's risk management activities. The amendments in this update also make certain targeted improvements to simplify the application of hedge accounting guidance and ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness. The amendments are effective for the fiscal years, and interim reporting periods within those years, beginning on or after December 15, 2018. For cash flow and net investment hedges existing at the date of adoption, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the update. We early adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Under the ASU, an entity will account for the effects of a modification unless (i) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified, (ii) the vesting conditions of the modified award are the same vesting conditions as the original award immediately before the original award is modified, and (iii) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in this ASU are effective prospectively for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. We adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments in this update clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this update provide a screen to determine when a set (integrated set of assets and activities) is not a business. If the screen is not met, it (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) removes the evaluation of whether a market participant could replace the missing elements. The amendments in ASU 2017-01 are effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. The amendments in this ASU should be applied prospectively on or after the effective date. We adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. Current generally accepted accounting principles prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until after the asset has been sold to an outside party. The amendments in ASU 2016-16 eliminates this prohibition. Accordingly an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Amendments in this update are effective for annual reporting periods beginning after December 15, 2017. We adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 provides specific guidance on eight cash flow issues where current guidance is unclear or does not include any specifics on classification. The eight specific cash flow issues are: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with zero coupon interest rates that are insignificant in relation to the effective interest rate of the 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 bank-owned policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in ASU 2016-15 are effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. Amendments should be applied using a retrospective transition method to each period presented. We adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This amendment requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under the equity method of accounting or those that result in the consolidation of the investee). The amendments in this update will be effective for fiscal years beginning after December 15, 2017. We adopted this ASU on January 1, 2018 and this ASU did not have a material impact on our consolidated financial statements or related footnote disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 removes inconsistencies and weaknesses in revenue requirements, provides a more robust framework for addressing revenue issues, improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets, provides more useful information to users of financial statements through improved disclosure requirements and simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. This guidance requires that an entity depict the consideration by applying a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. On April 1, 2015, the FASB voted for a one-year deferral of the effective date of the new revenue recognition standard, ASU 2014-09. On July 15, 2015, the FASB affirmed these changes, which requires public entities to apply the amendments in ASU 2014-09 for annual reporting beginning after December 15, 2017. Subsequent to the issuance of this ASU, the FASB issued three amendments: ASU No. 2016-08, which clarifies principal versus agent considerations; ASU 2016-10, which clarifies guidance related to identifying performance obligations and licensing implementation; and ASU 2016-12, which provides narrow-scope improvements and practical expedients. All of the amendments have the same effective date mentioned above.

We adopted the standard effective January 1, 2018. See Note 5, Revenue for a discussion of the impact and the required enhanced disclosures.

ICU MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recently Issued Accounting Standards

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this update modify the disclosure requirements in Topic 820. The amendments remove from disclosure: the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels 3; and the valuation processes for Level 3 fair value measurements. The amendments also made the following disclosure modifications: for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly; and the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The amendments also added the following disclosure requirements: the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period; and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. The amendments in ASU 2018-02 are effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. We are currently evaluating the impact of this ASU on the consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments in this update also require certain disclosures about stranded tax effects. The amendments in ASU 2018-02 are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. We are currently evaluating the impact of this ASU on the consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The amendments in this update remove the second step of the impairment test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The amendments in ASU 2017-04 are effective for the annual or interim impairment test in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. This ASU is not expected to have a material impact on our consolidated financial statements or related footnote disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This update amends the FASB's guidance on the impairment of financial instruments by requiring timelier recording of credit losses on loans and other financial instruments. The ASU adds an impairment model that is based on expected losses rather than incurred losses. The ASU also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update will be effective for fiscal years beginning after December 15, 2019. Early adoption is permitted as of the fiscal years beginning after December 15, 2018. The updated guidance requires a modified retrospective adoption. We are currently evaluating the impact of this ASU on the consolidated financial statements and related disclosures.

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In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amendments in this update require an entity to recognize a right-of-use asset and lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as finance or operating lease. The amendments also require certain quantitative and qualitative disclosures about leasing arrangements. The updated guidance requires a modified retrospective adoption. In July 2018, the FASB issued ASU No. 2018-11, Targeted Improvements. The amendments in this update will provide entities with an additional (and optional) transition method to adopt the new lease requirements by allowing entities to initially apply the requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The amendments in this update also provide lessors with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease contract. This expedient is limited to circumstances in which the nonlease components otherwise would be accounted for under the new revenue guidance and both (1) the timing and pattern of transfer are the same for the nonlease components and associated lease component and (2) the lease component, if accounted for separately, would be classified as an operating lease. If the lessor uses this practical expedient they would account for the lease contract in accordance with Topic 606 if the nonlease component is the predominant component otherwise, the lessor should account for the combined component as an operating lease in accordance with Topic 842. In July 2018, the FASB issued ASU No. 2018-10, Codification Improvements to Topic 842, Leases. This ASU clarifies certain language in ASU 2016-02 and corrects certain references and inconsistencies. As we have not yet adopted ASU 2016-02, the effective date of ASU 2018-11and ASU 2018-10 is the same as ASU 2016-02. We are currently evaluating the impact of these ASUs on the consolidated financial statements and related disclosures. Early adoption is permitted. The amendments in these updates will be effective for fiscal years beginning after December 15, 2018.

Note 3: Acquisition, Strategic Transaction and Integration Expenses

Acquisitions

On February 1, 2017, we acquired 100% interest in Fannin (UK) Limited ("Fannin") for total consideration of approximately $1.5 million. Fannin provides infusion therapy consumable products to the healthcare sector in the United Kingdom and Ireland.

On February 3, 2017, we acquired 100% interest in Pfizer Inc.’s (“Pfizer”) Hospira Infusion Systems ("HIS") business for total cash consideration of approximately $255.8 million (net of estimated working capital adjustments paid at closing), which was financed with existing cash balances and a $75 million three-year interest-only seller note. We also issued 3.2 million shares of our common stock. The fair value of the common shares issued to Pfizer was determined based on the closing price of our common shares on the issuance date, discounted to reflect a contractual lock-up period whereby Pfizer cannot transfer the shares, subject to certain exceptions, until the earlier of (i) the expiration of Pfizer’s services to us in the related transitional services agreement or (ii) eighteen months from the closing date. Additionally, Pfizer also may be entitled up to an additional $225 million in cash contingent consideration based on the achievement of performance targets for the combined company for the three years ending December 31, 2019 ("Earnout Period"). In the event that the sum of our Adjusted EBITDA as defined in the Amended and Restated Stock and Asset Purchase Agreement between us and Pfizer (the “HIS Purchase Agreement”) for the three years in the Earnout Period (the "Cumulative Adjusted EBITDA") is equal to or exceeds approximately $1 billion ("the "Earnout Target"), then Pfizer will be entitled to receive the full amount of the earnout. In the event that the Cumulative Adjusted EBITDA is equal to or greater than 85% of the Earnout Target (but less than the Earnout Target), Pfizer will be entitled to receive the corresponding percentage of the earnout. In the event that the Cumulative Adjusted EBITDA is less than 85% of the Earnout Target, then no earnout amount will be earned by Pfizer. The initial fair value of the earn-out was determined by employing a Monte Carlo simulation in a risk neutral framework. The underlying simulated variable was adjusted EBITDA. The adjusted EBITDA volatility estimate was based on a study of historical asset volatility for a set of comparable public companies. The model includes other assumptions including the market price of risk, which was calculated as the weighted average cost of capital ("WACC") less the long-term risk-free rate. We believe that the acquisition of the HIS business, which includes IV pumps, solutions and consumable devices complements our pre-existing business by creating a company that has a complete infusion therapy product portfolio. We believe that the acquisition significantly enhances our global footprint and platform for continued competitiveness and growth.

The purchase price allocation for HIS was completed during the fourth quarter of 2017.

Final Purchase Price

The following table summarizes the final purchase price and the final allocation of the purchase price related to the assets and liabilities purchased (in thousands, except per share data):

ICU MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash consideration for acquired assets	$180,785
Fair value of Seller Note	75,000
Fair value of contingent consideration payable to Pfizer (long-term)	19,000
Issuance of ICU Medical, Inc. common shares:	
Number of shares issued to Pfizer	3,200
Price per share (ICU's trading closing share price on the Closing Date)	$140.75
Market price of ICU shares issued to Pfizer	$450,400
Less: Discount due to lack of marketability of 8.3%	(37,261)
Equity portion of purchase price	413,139
Total Consideration	$687,924
Purchase Price Allocation:	
Cash and cash equivalents	$31,082
Trade receivables	362
Inventories	417,622
Prepaid expenses and other assets	13,911
Property and equipment	288,134
Intangible assets(1)	131,000
Other assets	29,270
Accounts payable	(12,381)
Accrued liabilities	(47,936)
Long-term liabilities(2)	(67,170)
Total identifiable net assets acquired	$783,894
Deferred tax liability	(25,080)
Gain on Bargain Purchase	(70,890)
Purchase Consideration	$687,924

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(1) Identifiable intangible assets includes $48 million of customer relationships, $44 million of developed technology - pumps and dedicated sets, $34 million of developed technology - consumables, and $5 million of in-process research and development ("IPR&D"). The weighted amortization period are as follows: approximately nine years for the total identifiable assets; eight years for customer relationships; ten years for the developed technology - pumps and dedicated sets; and twelve years for the developed technology - consumables. The IPR&D is non-amortizing until the associated research and development efforts are complete.

(2) Long-term liabilities primarily consisted of contract liabilities, product liabilities and long-term employee benefits.

The fair value of the assets acquired and liabilities assumed exceeded the fair value of the consideration to be paid resulting in a bargain purchase gain. Before recognizing a gain on a bargain purchase, we reassessed the methods used in the purchase accounting and verified that we had identified all of the assets acquired and all of the liabilities assumed, and that there were no additional assets or liabilities to be considered. We also reevaluated the fair value of the contingent consideration transferred to determine that it was appropriate. We determined that the bargain purchase gain was primarily attributable to expected restructuring costs as well as a reduction to the initially agreed upon transaction price caused primarily by revenue shortfalls across all market segments of the HIS business, negative manufacturing variance due to the drop in revenue and higher operating and required stand up costs, when compared to forecasts of the HIS business at the time that the purchase price was agreed upon. After the continuing review of the product demand and operations of the HIS business, including the resulting expected restructuring activities, we forecasted our estimated Adjusted EBITDA from the HIS business in 2017 to be $35 million - $40 million, which is considerably lower than the forecast contemplated in initial negotiations with Pfizer, which resulted in an estimated fair value of $19 million related to the $225 million earn out. Restructuring costs, if incurred, would be expensed in future periods (see Note 4: Restructuring Charges). The bargain purchase gain is separately stated below income from operations in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2017.

The identifiable intangible assets and other long-lived assets acquired have been valued as Level 3 assets at fair market value. The estimated fair value of identifiable intangible assets were developed using the income approach and are based on critical estimates, judgments and assumptions derived from analysis of market conditions, discount rate, discounted cash flows, royalty rates, customer retention rates and estimated useful lives. Fixed assets were valued with the consideration of remaining economic lives. The raw materials inventory was valued at historical cost and adjusted for any obsolescence, the work in process was valued at estimated sales proceeds less costs to complete and costs to sell, and finished goods inventory was valued at estimated sales proceeds less costs to sell. The prepaid expenses and other current assets and assumed liabilities were recorded at their carrying values as of the date of the acquisition, as their carrying values approximated their fair values due to their short-term nature.

On November 29, 2017, we acquired Medical Australia for total consideration of $9.0 million. Medical Australia delivers similar consumable Infusion products as our current businesses to Australia and surrounding regions. The purchase price allocation is preliminary and subject to future revision as the acquired assets and liabilities assumed are dependent upon the finalization of the related valuations.

Strategic Transaction and Integration Expenses

We incurred and expensed $23.5 million and $61.3 million in transaction and integration expenses during the three and nine months ended September 30, 2018 primarily related to the integration of the HIS business. These costs primarily related to consulting, legal and the transitional service agreement. We incurred $15.5 million and $49.0 million in transaction and integration expenses during the three and nine months ended September 30, 2017, respectively. The transaction and integration expenses were primarily related to our acquisition of the HIS business.

Note 4: Restructuring Charges

During the nine months ended September 30, 2018 and the year ended December 31, 2017, restructuring charges were incurred as a result of integrating the HIS acquired operations into our business and include severance costs related to involuntary employee terminations and facility exit costs related to the closure of the Dominican Republic manufacturing facility, which was sold in March 2018. All material charges in regard to these restructuring activities have been incurred as of September 30, 2018. The cumulative amount incurred to date in connection with the HIS acquisition is $21.8 million. Restructuring charges are included in the restructuring, strategic transaction and integration line item in our condensed consolidated statement of operations.

During the year ended December 31, 2015, we incurred restructuring charges related to an agreement with Dr. Lopez, a member of our Board of Directors and a former employee in our research and development department, pursuant to which we bought out Dr. Lopez's right to employment under his then-existing employment agreement. The buy-out, including payroll taxes, is paid in equal monthly installments until December 2020.

The following table summarizes the details of changes in our restructuring-related accrual for the period ended September 30, 2018 (in thousands):

	Accrued Balance December	Charges Incurred	Payments	Other Adjustments	Accrued Balance

	31, 2017				September 30, 2018
Severance pay and benefits	$ 915	$ 2,870	$ (3,327)	$ —	$ 458
Employment agreement buyout	1,114	—	(287)	2	829
Facility closure expenses	—	160	(160)	—	—
	$ 2,029	$ 3,030	$ (3,774)	$ 2	$ 1,287

Note 5: Revenue

ICU MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Adoption of ASC Topic 606, “Revenue from Contracts with Customers”
We adopted ASU No. 2014-09, Revenue from Contracts with Customers (ASC Topic 606), effective January 1, 2018 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting beginning after January 1, 2018 are presented under ASC Topic 606, while prior period amounts are not adjusted and will continue to be reported in accordance with our historic accounting under ASC Topic 605, Revenue Recognition.

Due to the cumulative impact, net of tax, of adopting ASC Topic 606, we recorded a net increase of $6.3 million to opening retained earnings as of January 1, 2018. The impact is primarily related to our bundled arrangements where we sell software licenses and implementation services, in addition to equipment, consumables and solutions. Under ASC Topic 605, revenue for the equipment was recognized upon delivery and software licenses and implementation services were typically recognized over the contract term. Under ASC Topic 606, revenue for the bundled equipment, software and software implementation services are recognized upon implementation. This results in an acceleration of software related revenue, offset by a delay in the recognition of related revenue of the equipment. Under ASC Topic 605, consumables and solutions revenues were typically recognized upon delivery. Under ASC 606, consumables and solutions revenues are recognized as the customer obtains control of the asset, which is at shipping point. This results in an acceleration in the recognition of consumables and solutions revenue.

Additionally, the timing of revenue recognition for software license renewals changed under ASC Topic 606. Under ASC Topic 605, revenue related to software renewals was recognized on a ratable basis over the license period. Under ASC Topic 606, the license, which is considered functional IP, is considered to be transferred to the customer at a point in time, specifically, at the start of each annual renewal period. As a result, under ASC Topic 606, revenue related to our annual software license renewals is accelerated when compared to ASC Topic 605.

Revenues are recognized when control of the promised goods or services is transferred to the customer, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

The following tables represent the amounts by which each financial statement line item is affected in the current year as a result of applying ASC Topic 606 (in thousands):

	For the three months ended September 30, 2018			For the nine months ended September 30, 2018		
	As Reported	Without Adoption of ASC 606	Effect of Adoption	As Reported	Without Adoption of ASC 606	Effect of Adoption
Revenue	$327,169	$340,671	$(13,502)	$1,059,662	$1,062,980	$(3,318)
Cost of goods sold	$192,582	$196,159	$(3,577)	$624,274	$626,810	$(2,536)
Gross Profit	$134,587	$144,512	$(9,925)	$435,388	$436,170	$(782)

	As of September 30, 2018		
	As Reported	Without Adoption of ASC Topic 606	Effect of Adoption
Prepaid expenses and other current assets	26,306	$26,872	$(566)
Accrued liabilities	131,954	$140,107	$(8,153)
Deferred income taxes	20,341	$22,340	$(1,999)

Revenue Recognition

The following table represents our revenues disaggregated by geography (in thousands):

ICU MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the three months ended September 30,		For the nine months ended September 30,	
Geography	2018	2017 [1]	2018	2017 [1]
EMEA	$30,759	$31,034	$104,150	$87,892
APAC	17,779	16,982	54,813	44,071
LATAM	16,051	16,349	44,701	42,034
North America	17,739	21,939	54,684	50,037
Other	—	120	80	120
Total Foreign	82,328	86,424	258,428	224,154
United States	244,841	256,812	801,234	698,335
Total Revenues				