IDEXX LABORATORIES INC /DE
Form 10-Q
October 23, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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: 0-19271

IDEXX LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**01-0393723**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
ONE IDEXX DRIVE, WESTBROOK, MAINE	**04092**
(Address of principal executive offices)	*(ZIP Code)*

207-556-0300

(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 o No o

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. The number of shares outstanding of the registrant s Common Stock, $0.10 par value, was 58,592,100 on October 19, 2009.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)
(Unaudited)

	September 30, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 106,728	$ 78,868
Accounts receivable, net of reserves of $2,428 in 2009 and $2,093 in 2008	115,141	111,498
Inventories, net	124,488	115,926
Deferred income tax assets	23,377	21,477
Other current assets	15,993	28,121
Total current assets	385,727	355,890
Long-Term Assets:		
Property and equipment, net	196,542	189,646
Goodwill and other intangible assets, net	214,974	207,095
Other long-term assets, net	17,646	12,806
Total long-term assets	429,162	409,547
TOTAL ASSETS	$ 814,889	$ 765,437
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable, principally trade accounts	$ 21,465	$ 28,006
Accrued expenses	38,031	32,857
Accrued employee compensation and related expenses	39,680	43,252
Accrued taxes	6,246	13,324
Accrued customer programs	18,749	15,183
Current portion of line of credit	62,597	150,620
Current portion of long-term debt	801	765
Current portion of deferred revenue	10,994	11,285
Total current liabilities	198,563	295,292
Long-Term Liabilities:		
Deferred tax liabilities	16,099	11,933
Line of credit, net of current portion	80,000	
Long-term debt, net of current portion	4,489	5,094
Long-term deferred revenue, net of current portion	3,832	3,787
Other long-term liabilities	12,272	11,137
Total long-term liabilities	116,692	31,951

Total liabilities		315,255		327,243
Commitments and Contingencies (Note 13)				
Stockholders Equity:				
Common stock, $0.10 par value: Authorized: 120,000 shares; Issued: 96,161 and 95,387 shares in 2009 and 2008, respectively		9,616		9,539
Additional paid-in capital		573,590		547,692
Deferred stock units: Outstanding: 116 and 102 units in 2009 and 2008, respectively		4,264		3,647
Retained earnings		793,305		702,031
Accumulated other comprehensive income		8,440		5,675
Treasury stock, at cost: 37,631 and 36,164 shares in 2009 and 2008, respectively		(889,581)		(830,390)
Total stockholders equity		499,634		438,194
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	814,889	$	765,437

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008
Revenue:				
Product revenue	$ 171,527	$ 167,144	$ 503,488	$ 526,622
Service revenue	87,593	83,949	257,810	254,115
Total revenue	259,120	251,093	761,298	780,737
Cost of Revenue:				
Cost of product revenue	71,543	65,435	202,114	200,714
Cost of service revenue	57,100	57,509	165,834	170,778
Total cost of revenue	128,643	122,944	367,948	371,492
Gross profit	130,477	128,149	393,350	409,245
Expenses:				
Sales and marketing	41,504	41,527	124,365	129,742
General and administrative	28,185	29,705	88,047	89,407
Research and development	16,583	17,920	49,116	53,489
Income from operations	44,205	38,997	131,822	136,607
Interest expense	(436)	(1,242)	(1,535)	(3,486)
Interest income	48	682	348	1,798
Income before provision for income taxes	43,817	38,437	130,635	134,919
Provision for income taxes	12,281	12,738	39,361	42,305
Net income	$ 31,536	$ 25,699	$ 91,274	$ 92,614
Earnings per Share:				
Basic	$ 0.54	$ 0.43	$ 1.55	$ 1.54
Diluted	$ 0.52	$ 0.42	$ 1.50	$ 1.48
Weighted Average Shares Outstanding:				
Basic	58,656	59,473	58,911	60,121
Diluted	60,668	61,865	60,718	62,603

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	For the Nine Months Ended September 30, 2009	2008
Cash Flows from Operating Activities:		
Net income	$ 91,274	$ 92,614
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	37,218	35,517
Loss on disposal of property and equipment	2,324	653
Increase (decrease) in deferred compensation liability	370	(287)
Write-down of marketable securities	150	
Provision for uncollectible accounts	674	1,709
Provision for (benefit of) deferred income taxes	3,705	(926)
Share-based compensation expense	8,849	8,083
Tax benefit from exercises of stock options and vesting of restricted stock units	(3,851)	(5,906)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(1,132)	(5,000)
Inventories	(8,145)	(14,137)
Other assets	(3,126)	(380)
Accounts payable	(6,868)	(3,632)
Accrued liabilities	(5,241)	2,033
Deferred revenue	(698)	(527)
Net cash provided by operating activities	115,503	109,814
Cash Flows from Investing Activities:		
Purchases of property and equipment	(35,615)	(64,982)
Proceeds from disposition of pharmaceutical product lines	1,377	
Proceeds from sale of property and equipment	2,056	
Acquisitions of equipment leased to customers	(747)	(560)
Acquisitions of intangible assets and businesses, net of cash acquired	(6,680)	(8,649)
Net cash used by investing activities	(39,609)	(74,191)
Cash Flows from Financing Activities:		
Borrowings (payments) on revolving credit facilities, net	(8,798)	92,099
Payment of other notes payable	(731)	(542)
Purchase of treasury stock	(57,966)	(122,429)
Proceeds from exercises of stock options and employee stock purchase plans	13,104	14,856
Tax benefit from exercises of stock options and vesting of restricted stock units	3,851	5,906
Net cash used by financing activities	(50,540)	(10,110)
Net effect of changes in exchange rates on cash	2,506	(1,287)
Net increase in cash and cash equivalents	27,860	24,226
Cash and cash equivalents at beginning of period	78,868	60,360

Cash and cash equivalents at end of period	$ 106,728	$ 84,586
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 2,223	$ 3,615
Income taxes paid	$ 34,516	$ 43,234

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying unaudited, condensed consolidated financial statements of IDEXX Laboratories, Inc. (IDEXX, the Company, we or our) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the requirements of Regulation S-X, Rule 10-01 for financial statements required to be filed as a part of Form 10-Q.

The accompanying unaudited, condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries, and all other entities in which we have a variable interest and are determined to be the primary beneficiary. All material intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited, condensed consolidated financial statements reflect, in the opinion of our management, all adjustments necessary for a fair statement of our financial position and results of operations. The condensed balance sheet data at December 31, 2008 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the nine months ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year or any future period. These unaudited, condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2009, and our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission.

Certain reclassifications have been made to the prior year condensed consolidated financial statements to conform to the current year presentation. Reclassifications had no material impact on previously reported results of operations or financial position.

NOTE 2. ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the nine months ended September 30, 2009 are consistent with those discussed in Note 3 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008, except for the adoption of new accounting standards during the first nine months of 2009 as discussed below.

Recent Accounting Pronouncements

In June, 2009, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Codification (ASC) as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities in preparation of financial statements in conformity with U.S. GAAP. While the adoption of the ASC as of September 30, 2009 changes how we reference accounting standards, the adoption did not have an impact on our financial position, results of operations, or cash flows.

On January 1, 2009, the principles and requirements for how an acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired were revised. Disclosure requirements were also established, which will enable financial statement users to evaluate the nature and financial effects of business combinations. Among other things, the amendments to the accounting principles and requirements expand the definitions of a business and business combination, require recognition of contingent consideration at fair value on the acquisition date and require acquisition-related transaction costs to be expensed as incurred. See Note 3 for a discussion of our business combination activity.

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On January 1, 2009, we adopted the fair value measurements and disclosures provisions for nonfinancial assets and nonfinancial liabilities, which were previously deferred. These provisions establish a framework for measuring fair value and expand financial statement disclosures about fair value measurements. Items to which these provisions apply include nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities, or recurring fair value measurements of nonfinancial assets and nonfinancial liabilities, which are not disclosed at fair value in the consolidated financial statements. We did not have nonfinancial assets or nonfinancial liabilities covered by these provisions which required remeasurement upon adoption or during the nine months ended September 30, 2009, and therefore there was no impact of adoption on our financial position, results of operations, or cash flows.

On January 1, 2009, we adopted the accounting standard for ownership interests in subsidiaries held by parties other than the parent, which establishes accounting for the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. This accounting standard also establishes reporting requirements that provide enhanced disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The impact of adopting this accounting standard on our financial position, results of operations, and cash flows was not significant.

On January 1, 2009, we adopted amendments to the accounting standard addressing derivatives and hedging. The amendments change the disclosure requirements for derivative instruments and hedging activities, requiring enhanced disclosures about how and why an entity uses derivative instruments, how instruments are accounted for under U.S. GAAP, and how derivatives and hedging activities affect an entity s financial position, financial performance and cash flows. The adoption of these amendments required additional disclosure only, and therefore did not have an impact on our financial position, results of operations, or cash flows. See Note 17 for a discussion of our derivative instruments and hedging activities.

On January 1, 2009, we adopted amendments to the accounting standard addressing intangibles, goodwill and other assets. The amendments provided new guidance to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under U.S. GAAP. The adoption of these amendments did not have a significant impact on our financial position, results of operations, or cash flows. See Note 3 for a discussion of our business combination activities and Note 7 for a discussion of our intangible assets.

On June 30, 2009, we adopted amendments to the accounting standard for financial instruments. The amendments require disclosures about the fair value of financial instruments in interim as well as in annual financial statements. The adoption of these amendments has resulted in additional disclosures only in our interim financial statements, and therefore did not impact our financial position, results of operations or cash flows. See Note 9 for the carrying amount of our long-term debt and for a discussion of interest rate risk regarding our revolving credit facility, Note 16 for discussion of fair value measurements, and Note 17 for a discussion of our derivative instruments and hedging activities.

On June 30, 2009, we adopted amendments to the accounting standard addressing subsequent events. The amendments provide guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The amendments require entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. The amendments required additional disclosures only, and therefore did not have an impact on our financial position, results of operations, or cash flows. We have evaluated subsequent events through October 23, 2009, the date we have issued this Quarterly Report on Form 10-Q.

NOTE 3. ACQUISITIONS OF BUSINESSES AND OTHER ASSETS

We paid $6.7 million in cash and recognized a liability of $1.2 million to acquire businesses during the three months ended September 30, 2009. At September 30, 2009, the $1.2 million liability was reflected in accrued expenses on the condensed consolidated balance sheet and is payable to the sellers upon reconciliation of the final asset values of the businesses acquired, which we anticipate will occur in the fourth quarter of 2009. In relation to these acquisitions, we recognized tangible assets of $1.0 million and assumed liabilities of $0.5 million.

In August 2009, we acquired substantially all of the assets and assumed certain liabilities of VDIC, Inc. (VDIC). VDIC is located in Oregon and is a global provider of telemedicine and cytopathology services and also provides imaging procedures, such as MRI and CT scans, on a referral basis for clients within the Oregon area. In August 2009, we also acquired certain assets of Pet Detect. Pet Detect engages in the marketing, distributing and selling of temporary pet identification systems based on tear- and humidity-resistant printable pet collars. The main application for these collars is in veterinary practices with boarding and overnight stay facilities, as well as in kennels. These acquisitions were accounted for as business combinations.

In connection with these acquisitions, we recognized software with a fair value of $2.5 million, which was recorded to property and equipment and assigned a useful life of 7 years; amortizable intangible assets of $2.6 million; and goodwill of $2.3 million.

The amortizable intangible assets consisted of customer-related intangible assets of $1.6 million, product rights of $0.7 million, and other intangible assets of $0.3 million, all of which were assigned to the Companion Animal Group (CAG) segment, with weighted amortization periods of 12 years, 7 years and 5 years, respectively. The goodwill recognized (all of which is expected to be tax deductible) was assigned to the CAG segment.

We believe that the acquired businesses enhance our existing businesses by either expanding the geographic range of our existing businesses or expanding our existing product lines. We determined the purchase price of each acquired business based on our assessment of estimated future cash flows attributable to the business enterprise taken as a whole, the strength of the business in the marketplace, the strategic importance of the acquisition to IDEXX, and the seller s desire to be acquired by IDEXX versus perceived alternatives. We recognized goodwill based on the excess of the purchase price for each business over the fair values of the individual tangible and separately identified intangible assets acquired.

The results of operations of the acquired businesses have been included since their respective acquisition dates. Pro forma information has not been presented because such information is not material to the financial statements taken as a whole.

NOTE 4. SHARE-BASED COMPENSATION

For the nine months ended September 30, 2009, share-based compensation expense included $8.2 million for options, restricted stock units and deferred stock units with vesting conditions, and $0.4 million for employee stock purchase rights. Expense for deferred stock units issued under our Director Deferred Compensation Plan without vesting conditions of $0.2 million for the nine months ended September 30, 2009 and 2008 has not been included in share-based compensation in the table below as it relates to deferred stock units granted to directors in lieu of cash compensation. Share-based compensation expense has been included in our condensed consolidated statements of operations for the three and nine months ended September 30, 2009 and 2008, as follows (*in thousands*):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Cost of revenue	$ 368	$ 371	$ 937	$ 819
Sales and marketing	396	331	1,174	1,136
General and administrative	1,584	1,230	5,098	4,409
Research and development	504	486	1,449	1,517
Total	$ 2,852	$ 2,418	$ 8,658	$ 7,881

The fair value of options, restricted stock units, deferred stock units with vesting conditions, and employee stock purchase rights awarded during the nine months ended September 30, 2009 and 2008 totaled $15.7 and $18.0 million, respectively. The total unrecognized compensation cost for unvested share-based compensation awards outstanding at September 30, 2009, before consideration of estimated forfeitures, was $36.3 million. We estimate that this cost will be reduced by approximately $3.4 million related to forfeitures. The weighted average remaining expense recognition period at September 30, 2009 was approximately 1.8 years.

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Options

We determine the assumptions used in the valuation of option grants as of the date of grant. Differences in the stock price volatility, terms of options granted to different segments of employees, or risk-free interest rates may necessitate distinct valuation assumptions at those grant dates. As such, we may use different assumptions during the fiscal year if we grant options at different dates or with varying terms. The weighted averages of the valuation assumptions used to determine the fair value of each option grant on the date of grant and the weighted average estimated fair values were as follows:

	For the Nine Months Ended September 30, 2009	2008
Expected stock price volatility	30%	25%
Expected term, in years	4.8	4.9
Risk-free interest rate	1.6%	2.7%
Weighted average fair value of options granted	$ 9.97	$ 15.31

The total fair value of options vested during the nine months ended September 30, 2009 and 2008 was $9.7 million and $7.5 million, respectively.

Restricted and Other Deferred Stock Units with Vesting Conditions

The combined weighted average fair value per unit of restricted stock units and deferred stock units with vesting conditions granted during the nine months ended September 30, 2009 and 2008 was $34.70 and $56.78, respectively.

NOTE 5. INVENTORIES

Inventories include material, labor and overhead, and are stated at the lower of cost (first-in, first-out) or market. The components of inventories were as follows *(in thousands)*:

	September 30, 2009	December 31, 2008
Raw materials	$ 32,237	$ 32,575
Work-in-process	18,491	18,428
Finished goods	73,760	64,923
	$ 124,488	$ 115,926

NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment, net, consisted of the following (*in thousands*):

	September 30, 2009	December 31, 2008
Land and improvements	$ 6,927	$ 8,189
Buildings and improvements	90,565	90,042
Leasehold improvements	19,752	17,275
Machinery and equipment	109,027	106,632
Office furniture and equipment	25,271	22,804
Computer hardware and software	65,245	52,081

Construction in progress		29,383		23,175
		346,170		320,198
Less accumulated depreciation and amortization		149,628		130,552
Total property and equipment, net	$	196,542	$	189,646

Depreciation expense was $9.9 million and $29.4 million for the three and nine months ended September 30, 2009, respectively. Depreciation expense was $9.1 million and $26.5 million for the three and nine months ended September 30, 2008, respectively.

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NOTE 7. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets other than goodwill consisted of the following *(in thousands)*:

	September 30, 2009		December 31, 2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents	$ 9,443	$ 4,636	$ 9,748	$ 4,306
Product rights (1)	32,591	14,826	32,187	13,180
Customer-related intangible assets (2)	57,747	15,862	52,642	11,844
Other, primarily noncompete agreements	6,167	3,787	6,268	3,188
	$ 105,948	$ 39,111	$ 100,845	$ 32,518

(1) Product rights comprise certain technologies, licenses, trade names and contractual rights acquired from third parties.

(2) Customer-related intangible assets comprise customer lists and customer relationships acquired from third parties.

Amortization expense of intangible assets was $2.3 million and $7.0 million for the three and nine months ended September 30, 2009, respectively. Amortization expense of intangible assets was $2.7 million and $7.9 million for the three and nine months ended September 30, 2008, respectively.

See Note 3 for a discussion of amortizable intangible assets recognized during the nine months ended September 30, 2009. The remaining changes in the cost of intangible assets other than goodwill during the nine months ended September 30, 2009 resulted from changes in foreign currency exchange rates.

Goodwill by segment consisted of the following *(in thousands)*:

	September 30, 2009	December 31, 2008
Companion animal group segment	$ 117,335	$ 109,502
Water segment	13,986	12,757
Production animal segment	10,285	9,978
Other segment	6,531	6,531

	$ 148,137	$ 138,768

See Note 3 for a discussion of goodwill recognized during the nine months ended September 30, 2009. The remaining changes in goodwill during the nine months ended September 30, 2009 resulted from changes in foreign currency exchange rates.

NOTE 8. WARRANTY RESERVES

We provide for the estimated cost of instrument warranties in cost of product revenue at the time revenue is recognized based on the estimated cost to repair the instrument over its warranty period. As we develop and sell new instruments, our provision for warranty expense increases. Cost of revenue reflects not only estimated warranty expense for the systems sold in the current period, but also any changes in estimated warranty expense for the installed base that results from our quarterly evaluation of service experience. Our actual warranty obligation is affected by instrument performance in the customers environment and costs incurred in servicing instruments. Should actual service rates or costs differ from our estimates, which are based on historical data and projections of future costs, revisions to our estimated warranty liability would be required.

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Following is a summary of changes in accrued warranty reserves during the three and nine months ended September 30, 2009 and 2008 *(in thousands)*:

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008
Balance, beginning of period	$ 3,099	$ 1,579	$ 2,837	$ 1,667
Provision for warranty expense	1,225	1,096	3,357	2,154
Change in estimate, balance beginning of period	(225)	(167)	(573)	(246)
Settlement of warranty liability	(1,139)	(642)	(2,661)	(1,709)
Balance, end of period	$ 2,960	$ 1,866	$ 2,960	$ 1,866

NOTE 9. DEBT

At September 30, 2009, we had $142.6 million outstanding under our unsecured short-term revolving credit facility (Credit Facility) with a weighted average interest rate of 0.8%, of which $4.6 million was borrowed by our Canadian subsidiary and denominated in Canadian dollars. Of the total amount outstanding at September 30, 2009, $80 million has been classified as a long-term liability based on our ability and intent with regard to future use and repayment of balances outstanding. The applicable interest rates on our Credit Facility generally range from 0.375 to 0.875 percentage points (Credit Spread) above the London interbank rate or the Canadian Dollar-denominated bankers acceptance rate, dependent on our consolidated leverage ratio. Based on current market conditions, we believe that we could obtain an unsecured short-term revolving credit facility similar to our current Credit Facility; however, that facility would be at an interest rate that is approximately 2.25 percentage points higher than the interest rate on our current Credit Facility. Based on this difference, the fair market value of the debt would be approximately $945 thousand per $1 million of principal outstanding as of September 30, 2009, assuming the amounts outstanding at September 30, 2009 remained outstanding for the duration of the Credit Facility. The Credit Facility contains financial and other affirmative and negative covenants, as well as customary events of default, that would allow any amounts outstanding under the Credit Facility to be accelerated, or restrict our ability to borrow thereunder, in the event of noncompliance. The financial covenant requires our ratio of debt to earnings before interest, taxes, depreciation and amortization, as defined by the agreement, not to exceed 3-to-1. At September 30, 2009, we were in compliance with the covenants of the Credit Facility.

In May 2006, we acquired our Westbrook, Maine facility and assumed the related mortgage that had a face value of $6.5 million and stated interest rate of 9.875%. We recorded the mortgage at a fair market value of $7.5 million, based on the effective market interest rate at that time. The carrying amount of our long-term debt approximates fair market value based on current market prices for similar debt issues with similar remaining maturities.

In March 2009, we entered into two forward fixed interest rate swap agreements to manage the economic effect of variable interest obligations. See Note 17 for a discussion of our derivative instruments and hedging activities.

NOTE 10. INCOME TAXES

Our effective income tax rates for the three and nine months ended September 30, 2009 were 28.0% and 30.1%, respectively, compared with 33.1% and 31.4% for the three and nine months ended September 30, 2008, respectively. The decrease in our effective income tax rate for the three months ended September 30, 2009 compared to September 30, 2008 was primarily due to the recognition of tax benefits resulting from expiration of certain statutes of limitation and federal research and development tax incentives received during the three months ended September 30, 2009 that were not available for the three months ended September 30, 2008.

The decrease in the effective tax rate for the nine months ended September 30, 2009 as compared to the nine months ended September 30, 2008 relates primarily to the recognition of tax benefits resulting from expiration of certain statutes of limitation and federal research and development tax incentives received during the nine months ended

September 30, 2009 that were not available for the nine months ended September 30, 2008. The benefits were partly offset by a reduction in international deferred tax liabilities in 2008 due to a change in the statutory tax rates for a jurisdiction in which we operate. This non-recurring benefit of approximately $1.5 million reduced our effective income tax rate for the nine months ended September 30, 2008 by 1.1 percentage points.

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NOTE 11. COMPREHENSIVE INCOME

The following is a summary of comprehensive income for the three and nine months ended September 30, 2009 and 2008 *(in thousands)*:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net income	$ 31,536	$ 25,699	$ 91,274	$ 92,614
Other comprehensive income (loss):				
Foreign currency translation adjustments	7,053	(13,921)	14,024	(5,015)
Change in fair value of foreign currency contracts classified as hedges, net of tax	(2,975)	6,230	(11,433)	5,599
Change in fair value of interest rate swaps classified as hedges, net of tax	(537)		(201)	
Change in fair market value of investments, net of tax	133	(223)	375	(192)
Comprehensive income	$ 35,210	$ 17,785	$ 94,039	$ 93,006

NOTE 12. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock and vested deferred stock units outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased for the assumed exercise of dilutive options and other potentially dilutive securities using the treasury stock method, unless the effect is anti-dilutive.

The following is a reconciliation of shares outstanding for basic and diluted earnings per share *(in thousands)*:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Shares Outstanding for Basic Earnings per Share:				
Weighted average shares outstanding	58,540	59,374	58,799	60,025
Weighted average vested deferred stock units outstanding	116	99	112	96
	58,656	59,473	58,911	60,121
Shares Outstanding for Diluted Earnings per Share:				
Shares outstanding for basic earnings per share	58,656	59,473	58,911	60,121
Dilutive effect of options issued to employees and directors	1,876	2,304	1,685	2,378
	128	83	115	98

Dilutive effect of restricted stock units issued to employees				
Dilutive effect of unvested deferred stock units issued to directors	8	5	7	6
	60,668	61,865	60,718	62,603

Vested deferred stock units outstanding are included in shares outstanding for basic and diluted earnings per share because the associated shares of our common stock are issuable for no cash consideration, the number of shares of our common stock to be issued is fixed and issuance is not contingent.

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Certain options to acquire shares and restricted stock units have been excluded from the calculation of shares outstanding for dilutive earnings per share because they were anti-dilutive. The following table presents information concerning those anti-dilutive options and restricted stock units *(in thousands, except per share amounts)*:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Weighted average number of shares underlying anti-dilutive options	647	653	1,362	610
Weighted average exercise price per underlying share of anti-dilutive options	$ 52.91	$ 53.67	$ 44.76	$ 52.98
Weighted average number of shares underlying anti-dilutive restricted stock units		3	3	2

The following table presents additional information concerning the exercise prices of vested and unvested options outstanding at the end of the period (*in thousands, except per share amounts*):

	September 30,	
	2009	**2008**
Closing price per share of our common stock	$ 50.00	$ 54.80
Number of shares underlying options with exercise prices below the closing price	4,390	4,758
Number of shares underlying options with exercise prices equal to or above the closing price	568	403
Total number of shares underlying outstanding options	4,958	5,161

NOTE 13. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Significant commitments, contingencies and guarantees at September 30, 2009 are consistent with those discussed in our Annual Report on Form 10-K for the year ended December 31, 2008 in Note 12 to the consolidated financial statements.

NOTE 14. TREASURY STOCK

Our board of directors has authorized the repurchase of up to 40,000,000 shares of our common stock in the open market or in negotiated transactions. We believe that the repurchase of our common stock is a favorable investment and we also repurchase to offset the dilutive effect of our share-based compensation programs. Repurchases of our common stock may vary depending upon the level of other investing and financing activities and the share price. From the inception of the program in August 1999 to September 30, 2009, we repurchased 37,220,000 shares for $880.5 million. During that same period, we received 411,000 shares of stock with a market value of $9.1 million that were surrendered by employees in payment for the minimum required withholding taxes due on the exercise of stock options, the vesting of restricted stock units and the settlement of deferred stock units, and in payment for the exercise price of stock options.

Information about our treasury stock purchases and other receipts is presented in the table below *(in thousands, except per share amounts)*:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
Shares acquired	375	392	1,467	2,367
Total cost of shares acquired	$ 18,375	$ 20,143	$ 59,191	$ 123,800
Average cost per share	$ 48.99	$ 51.44	$ 40.34	$ 52.30

NOTE 15. SEGMENT REPORTING

We are organized into business units by market and customer group. Our reportable segments include: products and services for the veterinary market, which we refer to as our Companion Animal Group (CAG), water quality products (Water), and products for production animal health, which we refer to as our Production Animal Segment (PAS). We also operate two smaller segments that comprise products for dairy quality, which we refer to as Dairy, and products for the human medical diagnostic market, which we refer to as OPTI Medical. In addition, we maintain active research and development programs, some of which may materialize into the development and introduction of new technology, products or services. Financial information about our Dairy and OPTI Medical operating segments and other activities are combined and presented in an Other category because they do not meet the quantitative or qualitative thresholds for reportable segments.

CAG develops, designs, manufactures, and distributes products and performs services for veterinarians. Water develops, designs, manufactures, and distributes products to detect contaminants in water. PAS develops, designs, manufactures, and distributes products to detect disease in production animals. Dairy develops, designs, manufactures, and distributes products to detect contaminants in dairy products. OPTI Medical develops, designs, manufactures, and distributes point-of-care electrolyte and blood gas analyzers and related consumable products for the human medical diagnostics market. In connection with the restructuring of our pharmaceutical business in the fourth quarter of 2008, we realigned two of our remaining pharmaceutical product lines to Rapid Assay products within our CAG segment, and realigned the remainder of our pharmaceutical business, which comprised one product line and two out-licensing arrangements, to the Other category. The segment information for the three and nine months ended September 30, 2008 has been restated to conform to our presentation of reportable segments for the three and nine months ended September 30, 2009. Previously, financial information related to the product lines realigned to Rapid Assay and the product line and out-licensing arrangement realigned to Other were included in the pharmaceutical business and reported in our CAG segment.

Items that are not allocated to our operating segments are comprised primarily of corporate research and development expenses that do not align with one of our existing business or service categories, a portion of share-based compensation expense, interest income and expense, and income taxes. We allocate most of our share-based compensation expense to the operating segments. This allocation differs from the actual expense and consequently yields a difference between the total allocated share-based compensation expense and the actual expense for the total company, which is categorized as unallocated amounts.

The accounting policies of the segments are the same as those described in Notes 3 and 17 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008.

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The following is the segment information *(in thousands)*:

	For the Three Months Ended September 30,					
	CAG	Water	PAS	Other	Unallocated Amounts	Consolidated Total
2009						
Revenues	$ 214,461	$ 19,691	$ 15,943	$ 9,025	$	$ 259,120
Income (loss) from operations	$ 38,002	$ 8,416	$ 944	$ (244)	$ (2,913)	$ 44,205
Interest expense, net						388
Income before provision for income taxes						43,817
Provision for income taxes						12,281
Net income						$ 31,536
2008						
Revenues	$ 204,762	$ 20,321	$ 17,801	$ 8,209	$	$ 251,093
Income (loss) from operations	$ 28,800	$ 8,865	$ 3,482	$ 127	$ (2,277)	$ 38,997
Interest expense, net						560
Income before provision for income taxes						38,437
Provision for income taxes						12,738
Net income						$ 25,699

	For the Nine Months Ended September 30,					
	CAG	Water	PAS	Other	Unallocated Amounts	Consolidated Total
2009						
Revenues	$ 625,442	$ 54,707	$ 53,848	$ 27,301	$	$ 761,298
Income (loss) from operations	$ 106,993	$ 24,336	$ 11,002	$ (145)	$ (10,364)	$ 131,822
Interest expense, net						1,187

Income before provision for income taxes						130,635
Provision for income taxes						39,361
Net income						$ 91,274
2008						
Revenues	$ 637,534	$ 57,287	$ 60,452	$ 25,464	$	$ 780,737
Income (loss) from operations	$ 105,412	$ 23,437	$ 14,824	$ 634	$ (7,700)	$ 136,607
Interest expense, net						1,688
Income before provision for income taxes						134,919
Provision for income taxes						42,305
Net income						$ 92,614

Revenue by product and service category was as follows (*in thousands*):

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
	2009	**2008**	**2009**	**2008**
CAG segment revenue:				
Instruments and consumables	$ 83,922	$ 80,587	$ 239,889	$ 236,974
Rapid assay products	37,753	36,300	116,997	116,628
Laboratory and consulting services	76,419	73,536	222,987	222,984
Practice information systems and digital radiography	16,367	13,333	45,515	42,373
Pharmaceutical products		1,006	54	18,575
CAG segment revenue	214,461	204,762	625,442	637,534
Water segment revenue	19,691	20,321	54,707	57,287
PAS segment revenue	15,943	17,801	53,848	60,452
Other segment revenue	9,025	8,209	27,301	25,464
Total revenue	$ 259,120	$ 251,093	$ 761,298	$ 780,737

NOTE 16. FAIR VALUE MEASUREMENTS

Financial instruments consist mainly of cash and cash equivalents, investments, accounts receivable, derivative instruments, interest rate swap agreements, accounts payable, lines of credit, and notes payable. Financial instruments that potentially subject us to concentrations of credit risk are principally cash, cash equivalents, investments and accounts receivable. We place our investments in highly-rated financial institutions and money market funds invested in government securities. Concentration of credit risk with respect to accounts receivable is limited to certain customers to whom we make substantial sales. To reduce risk, we routinely assess the financial strength of our customers and closely monitor their amounts due to us and, as a consequence, believe that our accounts receivable credit risk exposure is limited. We maintain an allowance for potential credit losses, but historically have not experienced any significant credit losses related to an individual customer or group of customers in any particular industry or geographic area. The carrying amounts of our financial instruments, other than long-term debt, approximate fair market value because of the short maturity of those instruments. See Note 9 for the carrying amount of our long-term debt and for a discussion of interest rate risk regarding our revolving credit facility and Note 17 for a discussion of our derivative instruments and hedging activities.

U.S. GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. At September 30, 2009, our Level 1 assets included investments in money market funds and marketable securities related to a deferred compensation plan assumed in a business combination. The liability associated with this plan relates to deferred compensation, which is indexed to the performance of the underlying investments, and is included in our Level 1 liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. At September 30, 2009, our Level 2 liabilities included foreign currency hedge contracts and interest rate hedge contracts.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. At September 30, 2009, we had no Level 3 assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. We did not have any nonfinancial assets or nonfinancial liabilities which required remeasurement during the nine months ended September 30, 2009.

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The following table sets forth our financial assets and liabilities that were measured at fair value on a recurring basis at September 30, 2009 by level within the fair value hierarchy (*in thousands*):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2009
Assets				
Marketable securities (1)	$ 1,768	$	$	$ 1,768
Money market funds (2)	52,106			52,106
Liabilities				
Interest rate swaps (3)		319		319
Deferred compensation (4)	1,768			1,768
Foreign currency exchange contracts (5)		6,743		6,743

(1) Investments in marketable securities for a deferred compensation plan, which is included in other long-term assets.

(2) Short-term investment in registered funds and included in cash and cash equivalents.

(3) Interest rate swaps designated as cash flow hedges, included in accrued liabilities whereby we will receive variable interest rate payments in exchange for fixed interest payments on $80 million of

borrowings outstanding beginning on March 31, 2010, extending through March 30, 2012.

(4) Deferred compensation liability associated with the above-mentioned marketable securities, included in other long-term liabilities.

(5) Foreign currency hedge contracts, included in accrued liabilities. The notional value of these contracts is $110.8 million.

The following table sets forth our financial assets and liabilities that were measured at fair value on a recurring basis at December 31, 2008 by level within the fair value hierarchy (*in thousands*):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**	**Balance at December 31,**