OMNICELL INC /CA/
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

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 000-33043

Omnicell, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**94-3166458**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1201 Charleston Road

Mountain View, CA 94043

(650) 251-6100

(Address, including zip code, of registrant s principal executive offices and 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated file o

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

Yes o No x

As of November 7, 2006, there were 28,080,688 shares of the Registrant s Common Stock outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

OMNICELL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	September 30, 2006 (Unaudited)	December 31, 2005(1)
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 50,081	$ 29,536
Accounts receivable, net	32,667	29,456
Inventories	21,883	13,763
Receivables subject to a sales agreement	1,017	2,551
Prepaid expenses and other current assets	11,954	10,286
Total current assets	117,602	85,592
Property and equipment, net	4,742	4,727
Long-term receivables subject to a sales agreement	1,131	1,292
Purchased intangibles	1,672	2,504
Goodwill	3,127	3,127
Long-term notes receivable	8,167	325
Other assets	2,063	2,861
Total assets	$ 138,504	$ 100,428
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities:		
Accounts payable	$ 11,874	$ 6,901
Accrued liabilities	12,457	9,822
Deferred service revenue	7,600	6,526
Deferred gross profit	14,241	7,981
Obligation resulting from sale of receivables	1,017	2,551
Total current liabilities	47,189	33,781
Long-term obligation resulting from sale of receivables	1,131	1,292
Long-term deferred service revenue	10,350	9,867
Other long-term liabilities	125	250
Stockholders equity	79,709	55,238
Total liabilities and stockholders equity	$ 138,504	$ 100,428

(1) *Information derived from our December 31, 2005 audited Consolidated Financial Statements. The accompanying notes are an integral part of these condensed consolidated financial statements.*

OMNICELL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three months ended September 30, 2006	2005	Nine months ended September 30, 2006	2005
Revenues:				
Product	$ 32,938	$ 24,194	$ 87,393	$ 68,688
Services and other revenues	7,992	6,494	23,422	19,349
Total revenue	40,930	30,688	110,815	88,037
Cost of revenues:				
Cost of product revenues	15,383	10,572	40,511	32,157
Cost of services and other revenues	3,317	2,226	9,714	7,349
Total cost of revenues	18,700	12,798	50,225	39,506
Gross profits	22,230	17,890	60,590	48,531
Operating expenses:				
Research and development	2,878	2,143	7,858	7,584
Selling, general, and administrative	16,736	14,446	48,031	45,152
Restructuring, facility, severance charges and disposition of assets				406
Total operating expenses	19,614	16,589	55,889	53,142
Income (loss) from operations	2,616	1,301	4,701	(4,611)
Other income and expense	583	150	1,277	369
Income (loss) before provision for income taxes	3,199	1,451	5,978	(4,242)
Provision for income taxes	384	36	522	69
Net income (loss)	$ 2,815	$ 1,415	$ 5,456	$ (4,311)
Net income (loss) per share:				
Basic	$ 0.10	$ 0.05	$ 0.20	$ (0.17)
Diluted	$ 0.10	$ 0.05	$ 0.19	$ (0.17)
Shares used in computing net income per share:				
Basic	27,775	26,101	27,336	25,792
Diluted	29,450	27,297	28,795	25,792

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

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OMNICELL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, unaudited)

	Nine months ended September 30, 2006	2005
Operating activities:		
Net income (loss)	$ 5,456	$ (4,311)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	2,813	3,185
Provision for doubtful accounts	283	
Loss on disposal of property and equipment	60	3
Share-based stock compensation	6,116	
Provision for excess and obsolete inventories	2,074	
Changes in operating assets and liabilities:		
Accounts receivable, net	(3,494)	(8,237)
Inventories	(10,053)	(342)
Prepaid expenses and other current assets	(1,668)	(817)
Other assets	(7,044)	4,917
Accounts payable	4,971	500
Accrued liabilities	3,315	(594)
Deferred service revenue	1,537	2,703
Deferred gross profit	6,260	4,333
Other long-term liabilities	(106)	(1,840)
Net cash provided by (used in) operating activities	10,520	(500)
Investing activities:		
Acquisition of intangible and intellectual property	(677)	(323)
Purchases of short-term investments	(12)	(1,564)
Proceeds of short-term investments		10,701
Purchases of property and equipment	(2,056)	(1,645)
Proceeds from sale of property and equipment		4
Net cash (used in) provided by investing activities	(2,745)	7,173
Financing activities:		
Tax benefit from employee stock options	(106)	
Proceeds from issuance of common stock	12,876	3,345
Net cash provided by financing activities	12,770	3,345
Net increase in cash and cash equivalents	20,545	10,018
Cash and cash equivalents at beginning of period	29,536	19,482
Cash and cash equivalents at end of period	$ 50,081	$ 29,500

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

OMNICELL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Organization and Summary of Significant Accounting Policies

Description of the Company

Omnicell, Inc. (Omnicell, our, us, we, or the Company) was incorporated in California in 1992 under the name Omnicell Technologies, Inc. reincorporated in Delaware in 2001 as Omnicell, Inc. Our solutions for the healthcare industry are designed for many clinical areas of the healthcare facility the central pharmacy, nursing units, operating room, cardiac catheterization lab and the patient s bedside. Our solutions enable healthcare facilities to acquire, manage, dispense and administer medications and medical-surgical supplies, and are intended to enhance patient safety, reduce medication errors, improve workflow and increase operational efficiency. Our medication and supply dispensing systems facilitate the distribution of medications and medical-surgical supplies at the point of care. Our physician order management system streamlines communication between nursing and pharmacy staff. Each of these systems interfaces with healthcare facilities existing information systems to accurately capture and display critical patient data.

In 2002, we acquired two products, a central pharmacy storage and retrieval solution, now marketed as Omnicell PharmacyCentral, and SafetyMed, a mobile workflow and patient safety platform. In August 2003, we acquired BCX Technology, Inc., a provider of open bar code supply management systems now branded as OptiFlex open and integrated systems, to complement our cabinet-based supply solutions. In March 2004, we acquired Ariel Distributing, Inc. s closed-loop, controlled substance inventory management software for healthcare system pharmacies, marketed by Omnicell under the product name SecureVault . When used in combination, our products and services offer a comprehensive solution to enable healthcare facilities to enhance patient safety while improving operational efficiency. In August 2005, we opened a research and development facility in India.

As a result of our product development efforts and acquisitions, we offer end-to-end solutions for both the medication-use process and the medical-surgical supply chain, providing additional market opportunities in areas beyond our solutions traditional location in the healthcare facility the nursing unit. For the medication-use process, we provide the central pharmacy with a physician order management system, OmniLinkRxTM, Omnicell PharmacyCentral, SafetyPak, an automated medication packaging system, and SecureVault, a controlled substance inventory management system and OmniRxTM, our medication dispensing control system. In addition, we offer SafetyMed RN, a mobile nursing workflow automation solution for use at the patient bedside. For the medical-surgical supply chain, we provide Omnibuyer, our purchase requisition system, Omnisupplier, our controlled dispensing system, and Optiflex, our open shelf dispensing control system.

Basis of Presentation

The accompanying unaudited condensed consolidated financial information has been prepared by management, in accordance with accounting principles generally accepted in the United States pursuant to instructions to Form 10-Q and Article 10 of Regulation S-X related to interim financial information. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the Securities and Exchange Commission s rules and regulations. The consolidated financial statements include the Company and its wholly-owned subsidiaries, APRS, Inc., Omnicell HealthCare Canada, Inc., BCX Technology, Inc., and Omnicell Corporation (India) Private Limited. All significant inter-company accounts and transactions are eliminated in consolidation. In the opinion of management, all adjustments (which would include nomal recurring adjustments) necessary to present fairly our financial position as of September 30, 2006 and the results of operations and cash flows for all periods presented have been made. The condensed consolidated balance sheet as of December 31, 2005 has been derived from the audited financial statements as of that date.

The condensed consolidated financial statements should be read in conjunction with our December 31, 2005 audited consolidated financial statements included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission. The results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire fiscal year ending December 31, 2006.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period reported. Actual results could differ from those estimates. Estimates are used in accounting for, but not limited to, the allowance for doubtful accounts, inventory valuation, purchased residual interests, asset and goodwill impairments, sales commissions, accrued liabilities, share-based compensation and taxes. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined.

Foreign Currency Translation

The functional currency of our foreign subsidiary is the U.S. Dollar. Monetary assets and liabilities denominated in foreign currency are translated using the exchange rate on the balance sheet dates. Non-monetary assets and liabilities denominated in foreign currency are translated at historical exchange rates. Expenses are translated using monthly average exchange rates during the year. Translation adjustments resulting from this process are included as a component of other income (expense). Foreign currency transaction gains and losses are included in the determination of net income.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of investments in a money market account and trade receivables, including receivables with multi-year payment terms. Our products are sold primarily to customers and to distributors. We perform ongoing credit evaluations of our customers and maintain reserves for credit losses. Credit is extended based on such evaluations and collateral is generally not required. Credit losses have not traditionally been material and such losses have been within management s expectations. The majority of our receivables with multi-year payment terms are sold to a financing company. We maintain a reserve for potentially uncollectible accounts receivable based on our assessment of collectability. We assess collectability based on a number of factors, including past history, the number of days an amount is past due, credit ratings of our customers, current events and circumstances regarding the business of our customers and other factors that we believe are relevant.

Substantially all revenues for the three and nine months ended September 30, 2005 and 2006 were generated from customers in North America. No single customer accounted for more than 10% of total revenues for the three and nine months ended September 30, 2006 and 2005. Leasing companies did not account for any portion of accounts receivable at September 30, 2006; one leasing company accounted for 3% of accounts receivable at December 31, 2005.

Goodwill and Purchased Intangible Assets

We measure goodwill and other indefinite life intangible assets for impairment when indicators of impairment exist and at least on an annual basis. The intangible asset with an indefinite life consists of the trade name acquired as part of the BCX Technology, Inc. acquisition. No impairment of goodwill or intangible assets with an indefinite life was recognized during the three and nine months ended September 30, 2006 or 2005. We had goodwill of $3.1 million and an other indefinite life intangible asset of $0.2 million at September 30, 2006.

Purchased intangible assets with finite lives include acquired developed software technology, service contracts, customer relationships and backlog acquired in a business combination. Purchased intangible assets with finite lives are amortized on a straight-line basis over their useful lives of three to six years. Additionally, purchased intangible assets with finite lives are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. No impairment of purchased intangibles was recognized for the three and nine months ended September 30, 2006 and 2005.

Revenue Recognition

Our revenue recognition policy significantly impacts our results of operations because it determines the timing of when revenue is recognized. It also impacts the timing of certain expenses, such as commissions, as they are determined by the timing of the recognition of corresponding revenues. We follow specific and detailed policies on recognizing revenue. Revenue results are difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in future operating losses.

Revenues are derived primarily from sales of medication and supply dispensing systems and subsequent service agreements. We generally market these systems for sale with 30 day terms. Sales of accounts receivable to third-party leasing companies are marketed with multi-year payment terms. Medication dispensing and supply automation system sales, which are accounted for in accordance with American Institute of Certified Public Accountant s Statement of Position 97-2, Software Revenue Recognition, (SOP 97-2), as amended, are recognized when persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered and installations are complete; Omnicell s price to the customer is fixed or determinable; and collectability is reasonably assured.

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The majority of our product revenue is derived from the sale and installation of medication and supply dispensing systems. We ship our systems based on customer requested installation dates. Our field operations employees generally perform system installations. The installations are considered complete and revenue is recognizable when the database files are complete, the systems are configured and labeled, our software is installed and deemed functional, the basic interfaces are complete, the systems are in the customer-designated locations and the systems have been tested.

We further require our customers to confirm that we have completed our installation obligations by providing to us a customer certification form indicating the date Omnicell s installation obligations were completed. Delays at a customer site due to construction or other causes could result in our inability to install our systems, and therefore recognize revenue for those systems. We also sell our medication dispensing and supply automation systems through distributors in Asia, Australia, Europe, the Middle East and South America, and through a sales agent in Canada. We recognize revenue upon shipment of our systems to distributors. Sales made to distributors are under agreements requiring distributors to have firm binding customer commitments or customer purchase orders from identified end-users; except for our agreement with one distributor which allows no right of return, and therefore the sales and related costs of these transactions are also recognized upon shipment.

Revenues from multi-year payment arrangements are recognized upon completion of Omnicell s installation obligation, if any, and at the beginning of the non-cancelable payment term. Most of our multi-year payment receivables are sold to third-party leasing finance companies. We record revenue at the net present value of the payment stream utilizing an implicit interest rate comparable to those charged by a third-party leasing company.

We exclude from revenues any amount paid to us for a new sale that relates to the termination of an existing payment stream. Generally, we sell multi-year payment stream contracts to leasing companies and we have no obligation to those leasing companies once the receivable is sold. At September 30, 2006 and December 31, 2005, accounts receivable included approximately $0 and $1.6 million, respectively, due from finance companies for lease receivables sold. U.S. government customers sign five-year non-cancelable payment terms but are subject to one-year government budget funding cycles. In our judgment and based on our history with these accounts, we believe these receivables are collectible. However, in the future, if any of Omnicell s U.S. government customers do not receive their annual funding, our ability to collect payments on unsold leases could be impaired and may result in a write down of our unsold leases to U.S. government customers. Further, it could impair our ability to make additional sales to U.S. government customers and impair our ability to sell these receivables to third-party leasing companies. As of September 30, 2006 and December 31, 2005, the balance of our unsold leases to U.S. government customers was $9.1 million and $3.6 million, respectively.

Post-installation technical support, such as phone support, on-site service, parts and access to software upgrades, when and if available, is provided by Omnicell under separate support services terms. When support services are sold under multiple element arrangements, we allocate revenue to support services based on its fair value. We recognize revenue for support services ratably over the related support services contract period. In addition, we enter into professional services and training arrangements. We recognize revenue for these arrangements upon performance of such services. Deferred service revenue represents amounts received under service agreements for which the services have not yet been performed. Revenues from our Web-based procurement application are recognized ratably over the subscription period.

Sales of Accounts Receivable

We offer our customers multi-year, non-cancelable payment terms. We typically sell our customers multi-year payment agreements to a third-party leasing company. In these sales, we generally transfer customer accounts receivable to the leasing company on a non-recourse basis at the Company s book value so no gain is recorded on the transfer. In these non-recourse transfers, we remove the sold receivable from our assets as we have assessed that the sales should be accounted for as true sales in accordance with Statement of Financial Accounting Standard (SFAS) No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

Research and Development Expenses

Our policy is to expense research and development costs as incurred, other than certain software development costs. Our research and development expenses include engineering and development salaries, wages and benefits, prototyping and laboratory expenses, consulting expenses and engineering-related facilities and overhead charges. Most of the research and development expenses are personnel or facilities-related and are relatively fixed. Prototyping and consulting expenses vary depending on the stage of completion of various engineering and development projects.

Software Development Costs

Development costs related to software implemented in our medication and supply dispensing systems and incurred subsequent to the establishment of technological feasibility are capitalized and amortized over the estimated lives of the related products ranging from three to five years.

Technological feasibility is established upon completion of a working model, which is a matter of judgment using the guidelines of SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. All such development costs incurred prior to the completion of a working model are recognized as research and development expense. As of September 30, 2006 and December 31, 2005, the balance of capitalized software development costs was approximately $1.2 million and $1.7 million, respectively. These costs are reported as a component of other assets. Amortization of capitalized software development costs was $0.2 million and $0.3 million for the three months ended September 30, 2006 and 2005, respectively; $0.8 million and $0.9 million for the nine months ended September 30, 2006 and 2005, respectively.

Segment Information

Omnicell manages its business on the basis of one reportable segment. The Company s products and technologies share similar distribution channels and customers and are sold primarily to hospitals and healthcare facilities to improve patient safety and care and enhance operational efficiency.

We have one operating segment, medication and supply dispensing systems. Substantially all of our long-lived assets are located in the United States. For the three and nine months ended September 30, 2006 and 2005, substantially all of our total revenues and gross profits were generated by the medication and supply dispensing systems operating segment.