IDEXX LABORATORIES INC /DE
Form 10-Q
April 25, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

[ ]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: 000-19271

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 No

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 No

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

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

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 51,304,867 on April 16, 2014.

IDEXX LABORATORIES, INC.

Quarterly Report on Form 10-Q

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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)

	March 31, 2014	December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 286,203	$ 279,058
Accounts receivable, net of reserves of $3,784 in 2014 and $3,533 in 2013	179,919	158,038
Inventories	141,134	133,427
Deferred income tax assets	32,005	33,226
Other current assets	43,905	48,957
Total current assets	683,166	652,706
Long-Term Assets:		
Property and equipment, net	282,226	281,214
Goodwill	180,466	180,521
Intangible assets, net	57,281	58,844
Other long-term assets, net	59,185	57,231
Total long-term assets	579,158	577,810
TOTAL ASSETS	$ 1,262,324	$ 1,230,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 42,794	$ 29,941
Accrued liabilities	134,519	148,919
Line of credit	315,000	277,000
Current portion of long-term debt	1,050	1,035
Current portion of deferred revenue	23,810	21,458
Total current liabilities	517,173	478,353
Long-Term Liabilities:		
Deferred income tax liabilities	31,785	33,948
Long-term debt, net of current portion	150,090	150,359
Long-term deferred revenue, net of current portion	19,264	18,427
Other long-term liabilities	31,760	31,215

Total long-term liabilities	232,899	233,949
Total liabilities	750,072	712,302
Commitments and Contingencies (Note 12)		
Stockholders' Equity:		
Common stock, $0.10 par value: Authorized: 120,000 shares; Issued: 101,554 and 101,188 shares in 2014 and 2013, respectively	10,155	10,119
Additional paid-in capital	847,138	825,320
Deferred stock units: Outstanding: 122 in 2014 and 2013	5,104	5,110
Retained earnings	1,539,978	1,493,393
Accumulated other comprehensive income	14,445	13,622
Treasury stock, at cost: 50,264 and 49,649 shares in 2014 and 2013, respectively	(1,904,604)	(1,829,378)
Total IDEXX Laboratories, Inc. stockholders' equity	512,216	518,186
Noncontrolling interest	36	28
Total stockholders' equity	512,252	518,214
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,262,324	$ 1,230,516

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31,	
	2014	2013
Revenue:		
Product revenue	$ 219,392	$ 205,768
Service revenue	140,811	126,338
Total revenue	360,203	332,106
Cost of Revenue:		
Cost of product revenue	78,042	74,150
Cost of service revenue	80,064	73,982
Total cost of revenue	158,106	148,132
Gross profit	202,097	183,974
Expenses:		
Sales and marketing	67,848	59,397
General and administrative	41,089	41,631
Research and development	23,114	21,758
Income from operations	70,046	61,188
Interest expense	(2,774)	(835)
Interest income	471	444
Income before provision for income taxes	67,743	60,797
Provision for income taxes	21,150	15,930
Net income	46,593	44,867
Less: Net income attributable to noncontrolling interest	8	7
Net income attributable to IDEXX Laboratories, Inc. stockholders	$ 46,585	$ 44,860
Earnings per Share:		
Basic	$ 0.90	$ 0.82
Diluted	$ 0.89	$ 0.81
Weighted Average Shares Outstanding:		
Basic	51,617	54,588
Diluted	52,338	55,490

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	For the Three Months Ended March 31,	
	2014	2013
Net income	$ 46,593	$ 44,867
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	1,279	(8,447)
Unrealized (loss) gain on investments, net of tax (benefit) expense of ($32) in 2014 and $42 in 2013	(54)	72
Unrealized gain (loss) on derivative instruments:		
Unrealized (loss) gain, net of tax (benefit) expense of ($123) in 2014 and $1,699 in 2013	(253)	4,118
Less: reclassification adjustment for gains included in net income, net of tax (expense) benefit of ($47) in 2014 and $8 in 2013	(149)	(10)
Unrealized (loss) gain on derivative instruments	(402)	4,108
Other comprehensive income (loss), net of tax	823	(4,267)
Comprehensive income	47,416	40,600
Less: comprehensive income attributable to noncontrolling interest	8	7
Comprehensive income attributable to IDEXX Laboratories, Inc.	$ 47,408	$ 40,593

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Three Months Ended March 31, 2014	2013
Cash Flows from Operating Activities:		
Net income	$ 46,593	$ 44,867
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,394	13,513
(Gain) loss on disposal of property and equipment	(18)	27
(Decrease) increase in deferred compensation liability	(86)	114
Provision for uncollectible accounts	451	644
(Benefit of) provision for deferred income taxes	(835)	1,169
Share-based compensation expense	4,108	3,949
Tax benefit from share-based compensation arrangements	(6,747)	(5,310)
Changes in assets and liabilities:		
Accounts receivable	(21,707)	(23,722)
Inventories	2,200	(10,717)
Other assets	1,312	6,301
Accounts payable	1,857	5,567
Accrued liabilities	(10,231)	(16,216)
Deferred revenue	3,227	869
Net cash provided by operating activities	33,518	21,055
Cash Flows from Investing Activities:		
Purchases of property and equipment	(11,298)	(20,132)
Proceeds from disposition of pharmaceutical product lines	-	3,500
Acquisitions of a business, net of cash acquired	(1,161)	-
Acquisitions of intangible assets	(175)	(659)
Net cash used by investing activities	(12,634)	(17,291)
Cash Flows from Financing Activities:		
Borrowings on revolving credit facilities, net	38,000	48,000
Debt issue costs	(139)	-
Payment of notes payable	(253)	(238)
Repurchases of common stock	(70,279)	(63,778)
Proceeds from exercises of stock options and employee stock purchase plans	10,964	12,958
Tax benefit from share-based compensation arrangements	6,747	5,310
Net cash (used) provided by financing activities	(14,960)	2,252
Net effect of changes in exchange rates on cash	1,221	(1,638)
Net increase in cash and cash equivalents	7,145	4,378

Cash and cash equivalents at beginning of period	279,058	223,986
Cash and cash equivalents at end of period	$ 286,203	$ 228,364

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 condensed consolidated financial statements of IDEXX Laboratories, Inc. and its subsidiaries 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 this Quarterly Report on Form 10-Q. Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "IDEXX," the "Company," "we," "our" or "us" refer to IDEXX Laboratories, Inc. and its subsidiaries.

The accompanying condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries. We do not have any variable interest entities for which we are the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying 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. All such adjustments are of a recurring nature. The consolidated balance sheet data at December 31, 2013 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the full year or any future period. These condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 and our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report") filed with the Securities and Exchange Commission ("SEC").

Reclassifications and Revisions

Certain prior year amounts have been reclassified to conform with the current year presentation. Reclassifications had no material impact on previously reported results of operations, financial position or cash flows.

Revisions were made on the condensed consolidated statement of cash flows for the three months ended March 31, 2013 to correctly reflect non-cash investing activities embedded in accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheet at March 31, 2013. These revisions increased the operating cash flows related to the change in accounts payable, accrued liabilities and inventory for the three months ended March 31, 2013 by $0.4 million from the amounts previously reported, and decreased investing cash flows related to purchases of property and equipment by the same amount. The revisions to the condensed consolidated statements of cash flows noted above represent an error that is not deemed to be material, individually or in the aggregate, to the prior period condensed consolidated financial statements.

Note 2. ACCOUNTING POLICIES

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three months ended March 31, 2014 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2013 Annual Report.

NOTE 3. SHARE-BASED COMPENSATION

The fair value of options, restricted stock units, deferred stock units and employee stock purchase rights awarded during the three months ended March 31, 2014 and 2013 totaled $20.3 million and $16.6 million, respectively. The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at March 31, 2014 was $49.1 million, which will be recognized over a weighted average period of approximately 2.3 years.

We determine the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at each grant date. As such, we may use different assumptions for options granted throughout the year. Option awards are granted with an exercise price equal to the closing market price of our common stock at the date of grant. We have never paid any cash dividends on our common stock, and we have no intention to pay such a dividend at this time; therefore, we assume that no dividends will be paid over the expected terms of option awards. The weighted averages of the valuation assumptions used to determine the fair value of each option award on the date of grant and the weighted average estimated fair values were as follows:

	For the Three Months Ended March 31,	
	2014	2013
Expected stock price volatility	28 %	33 %
Expected term, in years1	5.7	4.6
Risk-free interest rate	1.5 %	0.9 %
Weighted average fair value of options granted	$ 35.94	$ 26.58

1 Options granted during the three months ended March 31, 2014 and 2013 have a contractual term of ten and seven years, respectively.

Note 4. Inventories

Inventories, which are stated at the lower of cost (first-in, first-out) or market, include material, conversion costs and inbound freight charges. The components of inventories were as follows (in thousands):

	March 31, 2014	December 31, 2013
Raw materials	$ 23,498	$ 23,766
Work-in-process	16,120	14,359
Finished goods	101,516	95,302
	$ 141,134	$ 133,427

Note 5. Goodwill and Intangible Assets, NET

The decrease in goodwill during the three months ended March 31, 2014 resulted from changes in foreign currency exchange rates. The decrease in intangible assets other than goodwill during the three months ended March 31, 2014 resulted primarily from the continued amortization of our intangible assets, partly offset by the impact of the acquisition of an immaterial business and certain intangible assets.

NOTE 6. Other NONCURRENT ASSETS

Other noncurrent assets consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Investment in long-term product supply arrangements	$ 12,577	$ 13,075
Customer acquisition costs, net	20,781	21,199
Other assets	25,827	22,957
	$ 59,185	$ 57,231

Note 7. Accrued liabilities

Accrued liabilities consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Accrued expenses	$ 44,567	$ 44,274
Accrued employee compensation and related expenses	48,105	62,474
Accrued taxes	15,386	16,508
Accrued customer programs	26,461	25,663
	$ 134,519	$ 148,919

Note 8. Repurchases of common STOCK

The following is a summary of our open market common stock repurchases for the three months ended March 31, 2014 and 2013 (in thousands, except per share amounts):

	For the Three Months Ended March 31, 2014	2013
Shares repurchased	576	687
Total cost of shares repurchased	$ 70,279	$ 63,778
Average cost per share	$ 122.04	$ 92.82

We primarily acquire shares by means of repurchases in the open market. However, we also acquire shares that are surrendered by employees in payment for the minimum required withholding taxes due on the vesting of restricted stock units and the settlement of deferred stock units, otherwise referred to herein as employee surrenders. We acquired 40,537 shares having a total cost of $5.0 million in connection with such employee surrenders during the three months ended March 31, 2014 compared to 45,181 shares having a total cost of $4.1 million during the three months ended March 31, 2013.

We issue shares of treasury stock upon the vesting of certain restricted stock units and upon the exercise of certain stock options. The number of shares of treasury stock issued during both the three months ended March 31, 2014 and 2013 was not material.

Note 9. Income Taxes

Our effective income tax rate was 31.2% and 26.2% for the three months ended March 31, 2014 and 2013, respectively. The increase in our effective rate for the three months ended March 31, 2014 as compared to the same period of the prior year was primarily related to the U.S. research and development (R&D) tax credit. During the quarter ended March 31, 2013, legislation in the U.S. retroactively allowed the R&D tax credit for all of 2012 and extended the credit through the year ended December 31, 2013. Because this legislation was enacted during the quarter ended March 31, 2013, the full benefit of the credit related to the prior years' activities was recognized within that quarter, lowering our effective tax rate significantly in that period. As of January 1, 2014, the R&D tax credit again expired, increasing our effective tax rate in the period ended March 31, 2014.

Note 10. ACCUMULATED OTHER Comprehensive Income

The changes in accumulated other comprehensive income, net of tax, for the three months ended March 31, 2014 consisted of the following (in thousands):

For the Three Months Ended March 31, 2014	Unrealized Gain on Investments, Net of Tax	Unrealized Loss on Derivative Instruments, Net of Tax	Cumulative Translation Adjustment	Total
Balance as of December 31, 2013	$ 108	$ (179)	$ 13,693	$ 13,622
Other comprehensive (loss) income before reclassifications	(54)	(253)	1,279	972
Gains reclassified from accumulated other comprehensive income	-	(149)	-	(149)
Balance as of March 31, 2014	$ 54	$ (581)	$ 14,972	$ 14,445

The following is a summary of reclassifications out of accumulated other comprehensive income for the three months ended March 31, 2014 and 2013 (in thousands):

Details about Accumulated Other Comprehensive Income Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified from Accumulated

		Other Comprehensive Income For the Three Months Ended March 31,	
		2014	2013
Gains (losses) on derivative instruments included in net income:			
Foreign currency exchange contracts	Cost of revenue	458	109
Interest rate swaps	Interest expense	(262)	(107)
	Total gains before tax	196	2
	Tax expense (benefit)	47	(8)
	Gains, net of tax	149	10

Note 11. Earnings per Share

Basic earnings per share is computed by dividing net income attributable to IDEXX Laboratories, Inc. stockholders 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 assumed issuance of unvested restricted stock units and unvested deferred stock units using the treasury stock method unless the effect is anti-dilutive. The treasury stock method assumes that proceeds, including cash received from the exercise of employee stock options, the total unrecognized compensation expense for unvested share-based compensation awards and the excess tax benefits resulting from share-based compensation tax deductions in excess of the related expense recognized for financial reporting purposes, would be used to purchase our common stock at the average market price during the period. 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. See Note 4 to the consolidated financial statements in our 2013 Annual Report for additional information regarding deferred stock units.

The following is a reconciliation of shares outstanding for basic and diluted earnings per share for the three months ended March 31, 2014 and 2013 (in thousands):

	For the Three Months Ended March 31,	
	2014	2013

Shares outstanding for basic earnings per share:	51,617	54,588
Shares outstanding for diluted earnings per share:		
Shares outstanding for basic earnings per share	51,617	54,588
Dilutive effect of share-based payment awards	721	902
	52,338	55,490

Certain options to acquire shares and restricted stock units have been excluded from the calculation of shares outstanding for diluted earnings per share because they were anti-dilutive. The following table presents information concerning those anti-dilutive options and restricted stock units for the three months ended March 31, 2014 and 2013 (in thousands):

	For the Three Months Ended March 31,	
	2014	2013
Weighted average number of shares underlying anti-dilutive options	217	441
Weighted average number of shares underlying anti-dilutive restricted stock units	41	-

Note 12. Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at March 31, 2014 are consistent with those discussed in Note 14 to the consolidated financial statements in our 2013 Annual Report.

Note 13. Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-maker is our Chief Executive Officer. Our reportable segments include diagnostic and information technology-based products and services for the veterinary market, which we refer to as the Companion Animal Group (“CAG”), water quality products (“Water”) and diagnostic tests for livestock and poultry health and to ensure the quality and safety of milk and food, which we refer to as Livestock, Poultry and Dairy (“LPD”). Our Other operating segment comprises products for the human point-of-care medical diagnostics market (“OPTI Medical”), which is combined and presented with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

Items that are not allocated to our operating segments are as follows: a portion of corporate support function and personnel-related expenses; certain manufacturing costs; corporate research and development expenses that do not align with one of our existing business or service categories; the difference between estimated and actual share-based compensation expense; and certain foreign currency exchange gains and losses. These amounts are shown under the caption "Unallocated Amounts."

We estimate our share-based compensation expense, corporate support function expenses and certain personnel-related costs and allocate the estimated expenses to the operating segments. This allocation differs from actual expense and consequently yields a difference that is reported under the caption "Unallocated Amounts."

With respect to manufacturing costs, the costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption "Unallocated Amounts."

Additionally, in certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption "Unallocated Amounts."

The following is a summary of segment performance for the three months ended March 31, 2014 and 2013 (in thousands):

	For the Three Months Ended March 31,					
	CAG	Water	LPD	Other	Unallocated Amounts	Consolidated Total
2014						
Revenue	$ 301,588	$ 21,421	$ 31,351	$ 5,843	$ -	$ 360,203
Income (loss) from operations	$ 55,864	$ 8,116	$ 6,460	$ 589	$ (983)	$ 70,046
Interest expense, net						(2,303)
Income before provision for income taxes						67,743
Provision for income taxes						21,150
Net income						46,593
Less: Net income attributable to noncontrolling interest						8
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 46,585
2013						
Revenue	$ 276,941	$ 20,666	$ 28,039	$ 6,460	$ -	$ 332,106
Income (loss) from operations	$ 51,309	$ 8,355	$ 4,836	$ 435	$ (3,747)	$ 61,188
Interest expense, net						(391)
Income before provision for income taxes						60,797
Provision for income taxes						15,930
Net income						44,867
Less: Net income attributable to noncontrolling interest						7
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 44,860

The following is a summary of revenue by product and service category for the three months ended March 31, 2014 and 2013 (in thousands):

	For the Three Months Ended March 31,	
	2014	2013
CAG segment revenue:		
CAG Diagnostics recurring revenue:	$ 258,763	$ 239,568
IDEXX VetLab® consumables	84,321	75,783
VetLab service and accessories	13,093	12,053
Rapid assay products	43,059	44,083
Reference laboratory diagnostic and consulting services	118,290	107,649

CAG Diagnostics capital - instruments	18,565	15,835
Customer information management and digital imaging systems	24,260	21,538
CAG segment revenue	301,588	276,941
Water segment revenue	21,421	20,666
LPD segment revenue	31,351	28,039
Other segment revenue	5,843	6,460
Total revenue	$ 360,203	$ 332,106

Note 14. FAIR VALUE MEASUREMENTS

U.S. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. U.S. GAAP requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

The Company has certain financial assets and liabilities that are measured at fair value on a recurring basis, certain nonfinancial assets and liabilities that may be measured at fair value on a nonrecurring basis and certain financial assets and liabilities that are not measured at fair value in our condensed consolidated balance sheets but for which we disclose the fair value. The fair value disclosures of these assets and liabilities are based on a three-level hierarchy, which is defined as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

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.
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.

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 transfers between Level 1 and Level 2 or transfers in or out of Level 3 of the fair value hierarchy during the three months ended March 31, 2014.

Our foreign currency exchange contracts and interest rate swap agreements are measured at fair value on a recurring basis in our accompanying condensed consolidated balance sheets. We measure the fair value of our foreign currency exchange contracts classified as derivative instruments using an income approach, based on prevailing market forward rates less the contract rate multiplied by the notional amount. The product of this calculation is then adjusted for counterparty risk. We measure the fair value of our interest rate swaps classified as derivative instruments using an income approach, utilizing a discounted cash flow analysis based on the terms of the contract and the interest rate curve adjusted for counterparty risk.

The amount outstanding under our unsecured revolving credit facility (“Credit Facility”), notes receivable and long-term debt are measured at carrying value in our accompanying condensed consolidated balance sheets though we disclose the fair value of these financial instruments. We determine the fair value of the amount outstanding under our Credit Facility, notes receivable and long-term debt using an income approach, utilizing a discounted cash flow analysis based on current market interest rates for debt issues with similar remaining years to maturity, adjusted for applicable credit risk. Our Credit Facility and long-term debt are valued using level 2 inputs, while our notes receivable, representing a strategic investment in a privately held company with a carrying value of $5.2 million as of March 31, 2014, are valued using level 3 inputs. The results of these calculations yield fair values that approximate carrying values.

The following tables set forth our assets and liabilities that were measured at fair value on a recurring basis at March 31, 2014 and at December 31, 2013 by level within the fair value hierarchy (in thousands):

As of March 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at March 31, 2014
Assets				
Money market funds(1)	$ 173,116	$ -	$ -	$ 173,116
Equity mutual funds(2)	2,765	-		