IDEXX LABORATORIES INC /DE
Form 10-Q
November 01, 2016

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 September 30, 2016

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 per share, was 89,658,209 on October 25, 2016.

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)

	September 30, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 150,072	$ 128,994
Marketable securities	241,402	213,591
Accounts receivable, net of reserves of $5,054 in 2016 and $5,128 in 2015	204,701	188,318
Inventories	168,468	188,833
Deferred income tax assets	-	39,829
Other current assets	63,457	62,069
Total current assets	828,100	821,634
Long-Term Assets:		
Property and equipment, net	349,664	333,026
Goodwill	180,952	178,934
Intangible assets, net	47,566	55,909
Other long-term assets	94,088	85,490
Total long-term assets	672,270	653,359
TOTAL ASSETS	$ 1,500,370	$ 1,474,993
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Accounts payable	$ 44,127	$ 52,648
Accrued liabilities	202,074	205,530
Line of credit	488,000	573,000
Current portion of deferred revenue	26,007	25,583
Total current liabilities	760,208	856,761
Long-Term Liabilities:		
Deferred income tax liabilities	20,571	49,389
Long-term debt	599,137	597,085

Long-term deferred revenue, net of current portion	30,874	27,055
Other long-term liabilities	34,594	28,698
Total long-term liabilities	685,176	702,227
Total liabilities	1,445,384	1,558,988
Commitments and Contingencies (Note 13)		
Stockholders' Equity (Deficit):		
Common stock, $0.10 par value: Authorized: 120,000 shares; Issued: 103,120 and 102,237 shares in 2016 and 2015, respectively	10,312	10,258
Additional paid-in capital	994,299	940,534
Deferred stock units: Outstanding: 231 and 240 units in 2016 and 2015, respectively	5,470	5,409
Retained earnings	488,033	318,356
Accumulated other comprehensive loss	(35,081)	(42,265)
Treasury stock, at cost: 13,413 and 12,242 shares in 2016 and 2015, respectively	(1,408,183)	(1,316,417)
Total IDEXX Laboratories, Inc. stockholders' equity (deficit)	54,850	(84,125)
Noncontrolling interest	136	130
Total stockholders' equity (deficit)	54,986	(83,995)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 1,500,370	$ 1,474,993

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 September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Product revenue	$ 266,321	$ 246,750	$ 800,273	$ 730,063
Service revenue	181,987	159,637	532,154	472,144
Total revenue	448,308	406,387	1,332,427	1,202,207
Cost of Revenue:				
Cost of product revenue	103,909	92,185	310,450	266,758
Cost of service revenue	97,669	89,928	287,167	262,874
Total cost of revenue	201,578	182,113	597,617	529,632
Gross profit	246,730	224,274	734,810	672,575
Expenses:				
Sales and marketing	79,972	73,107	236,453	223,460
General and administrative	52,627	46,198	156,239	133,717
Research and development	25,672	24,862	75,704	74,185
Impairment charge	-	8,212	-	8,212
Income from operations	88,459	71,895	266,414	233,001
Interest expense	(7,786)	(7,750)	(24,294)	(21,313)
Interest income	851	684	2,599	1,668
Income before provision for income taxes	81,524	64,829	244,719	213,356
Provision for income taxes	25,072	20,600	75,036	65,611
Net income	56,452	44,229	169,683	147,745
Less: Net (loss) income attributable to noncontrolling interest	(3)	6	7	16
Net income attributable to IDEXX Laboratories, Inc. stockholders	$ 56,455	$ 44,223	$ 169,676	$ 147,729
Earnings per Share:				
Basic	$ 0.63	$ 0.48	$ 1.89	$ 1.59
Diluted	$ 0.62	$ 0.48	$ 1.87	$ 1.57
Weighted Average Shares Outstanding:				
Basic	89,894	91,944	89,881	93,194

Diluted	91,138	92,897	90,960	94,262

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 September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$ 56,452	$ 44,229	$ 169,683	$ 147,745
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	1,687	(13,859)	10,873	(26,793)
Unrealized (loss) gain on net investment hedge	(732)	(396)	(1,649)	340
Unrealized gain (loss) on investments, net of tax expense of $19 and $134 in 2016 and ($60) and ($29) in 2015	9	(88)	334	(81)
Unrealized gain (loss) on derivative instruments:				
Unrealized (loss) gain, net of tax (benefit) expense of ($57) and ($694) in 2016 and $1,030 and $2,882 in 2015	(129)	2,495	(1,570)	6,793
Less: reclassification adjustment for gains included in net income, net of tax expense of ($197) and ($313) in 2016 and ($1,374) and ($4,079) in 2015	(451)	(3,369)	(804)	(9,681)
Unrealized loss on derivative instruments	(580)	(874)	(2,374)	(2,888)
Other comprehensive gain (loss), net of tax	384	(15,217)	7,184	(29,422)
Comprehensive income	56,836	29,012	176,867	118,323
Less: comprehensive (loss) income attributable to noncontrolling interest	(3)	6	7	16
Comprehensive income attributable to IDEXX Laboratories, Inc.	$ 56,839	$ 29,006	$ 176,860	$ 118,307

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, 2016		2015
Cash Flows from Operating Activities:			
Net income	$ 169,683		$ 147,745
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	57,977		51,227
Amortization on marketable securities, net	727		967
Impairment charge	2,228		8,212
Provision for uncollectible accounts	842		1,808
Provision for (benefit of) deferred income taxes	6,243		(4,649)
Share-based compensation expense	15,021		14,760
Other	1,160		(305)
Tax benefit from share-based compensation arrangements	(10,225)		(10,044)
Changes in assets and liabilities:			
Accounts receivable	(16,647)		(51,024)
Inventories	(2,503)		(27,238)
Other assets and liabilities	8,648		16,538
Accounts payable	(2,496)		(2,841)
Deferred revenue	3,798		(2,688)
Net cash provided by operating activities	234,456		142,468
Cash Flows from Investing Activities:			
Purchases of property and equipment	(49,956)		(67,517)

Purchase of marketable securities		(178,829)		(231,387)
Proceeds from the sale and maturities of marketable securities		152,277		24,711
Acquisitions of a business, net of cash acquired		-		(8,200)
Net cash used by investing activities		(76,508)		(282,393)
Cash Flows from Financing Activities:				
Repayments on revolving credit facilities, net		(85,000)		(6,500)
Debt issue costs		(57)		(199)
Issuance of long-term debt		-		250,097
Repurchases of common stock		(91,562)		(309,057)
Proceeds from exercises of stock options and employee stock purchase plans		28,815		19,221
Payment of acquisition-related contingent consideration		(3,633)		-
Tax benefit from share-based compensation arrangements		10,225		10,044
Net cash used by financing activities		(141,212)		(36,394)
Net effect of changes in exchange rates on cash		4,342		(5,067)
Net increase (decrease) in cash and cash equivalents		21,078		(181,386)
Cash and cash equivalents at beginning of period		128,994		322,536
Cash and cash equivalents at end of period	$	150,072	$	141,150

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, 2015 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three and nine months ended September 30, 2016 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 September 30, 2016 and our Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Annual Report") filed with the U.S. Securities and Exchange Commission ("SEC").

For the nine months ended September 30, 2016, changes in stockholders' equity included (i) changes in other comprehensive income reflected in the condensed consolidated statements of comprehensive income; (ii) changes in common stock and additional paid-in capital reflected in the condensed consolidated statements of cash flows (including share-based compensation expense, proceeds from exercise of stock options and employee stock purchase plans, tax benefit from share-based compensation arrangements and repurchases of common stock); (iii) changes in noncontrolling interest; and (iv) changes in net income.

Reclassifications

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.

Note 2. ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 30, 2016 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2015 Annual Report, except as noted below.

New Accounting Pronouncements Adopted

Deferred Income Taxes

During the first quarter of 2016, the Company early adopted Financial Accounting Standards Board ("FASB") amendments which require us to classify all deferred tax assets and liabilities as noncurrent within our condensed consolidated balance sheet. In accordance with the FASB's permitted transition guidance, we applied this guidance prospectively and did not revise our prior period balance sheet presentation for the effects of these amendments. These amendments did not have a material impact on our financial statements.

Deferred Financing Costs

Effective January 1, 2016, the Company adopted FASB amendments that require debt issuance costs related to a recognized debt liability be presented within the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This reclassification of the presentation of deferred financing costs did not have a material impact on other long-term assets or long-term debt amounts reported in our September 30, 2016 condensed consolidated balance sheet and additionally would not have a material impact on such amounts reported in a prior period. As such, these amendments have been reflected prospectively in 2016; prior period amounts have not been revised for the effects of this amendment.

The FASB confirmed in August 2015 that the aforementioned amendments did not address the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. For line-of-credit arrangements, borrowers have the option of presenting debt issuance costs as an asset which is subsequently amortized ratably over the term of the line-of-credit arrangement, regardless of whether there are any related outstanding borrowings. As such, we continue to present deferred financing costs associated with our unsecured revolving credit facility within other long-term assets in the accompanying condensed consolidated balance sheets. Following recognition within the condensed consolidated balance sheets, all deferred financing costs are amortized to interest expense over the term of the related debt agreement. These amendments did not have a material impact on our financial statements.

Internal-Use Software

Effective January 1, 2016, the Company prospectively adopted FASB amendments which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance does not change the current treatment for accounting for software licenses or service contracts. We evaluate implementation costs related to cloud computing arrangements that do not include a software license and defer the costs that enhance or modify the functionality of the cloud computing software within other current and long-term assets and amortize those costs over the expected benefit period. These implementation costs would have previously been capitalized as software within property and equipment. These amendments did not have a material impact on our financial statements.

Additional Pronouncements

During the three and nine months ended September 30, 2016, the adoption of other effective FASB amendments addressing measurement-period adjustments for business combinations and to the fair value hierarchy of investments measured at net asset value did not have a material impact on our financial statements.

New Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued an amendment which will replace most of the existing revenue recognition guidance within U.S. GAAP. The core principle of this guidance is that an entity should recognize revenue for the transfer of goods or services to customers in an amount that it expects to be entitled to receive for those goods or services. In doing so, companies will be required to make certain judgments and estimates, including identifying contract performance obligations, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price among separate performance obligations. Additionally, the amendment requires disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, significant judgments reached in the application of the guidance and assets recognized from the costs to obtain or fulfill a contract. In July 2015, the FASB voted to defer the effective date of the amendment to apply to public business entities for annual and interim periods beginning after December 15, 2017. The amendment allows for two methods of adoption: a full retrospective method or a modified retrospective approach with the cumulative effect recognized at the date of initial application. We are in the process of determining the method of adoption and the impact of this amendment on our consolidated financial statements.

In August 2014, the FASB issued an amendment that requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. The amendment in this update provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for one year after the date that the financial statements are issued and to provide related footnote disclosures. In doing so, the amendment should reduce diversity in the timing and content of footnote disclosures. The amendment in this update applies to all entities and is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This amendment is not expected to have a material impact on our financial statements.

In February 2015, the FASB issued amendments which change the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities, placing more emphasis on risk of loss when determining a controlling financial interest. The amendments in this update apply to all entities and are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. These amendments are not expected to have a material impact on our financial statements.

In July 2015, the FASB issued amendments which simplify the existing guidance which requires entities to subsequently measure inventory at the lower of cost or market value. Under the amendments, an entity should measure inventory valued using a first-in, first-out or average cost method at the lower of cost or net realizable value, which is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This update is effective for public business entities during fiscal years beginning after December 15, 2016. Early adoption is permitted. These amendments are not expected to have a material impact on our financial statements.

In February 2016, the FASB issued amendments to increase transparency and comparability among organizations' leasing arrangements. The principal difference from previous guidance is that effective upon adoption, the lease assets and lease liabilities arising from operating leases will be recognized in the statement of financial position. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In transition, we are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, including the option to utilize a number of practical expedients. The Company is in the process of evaluating our lessee and lessor arrangements to determine the impact of this amendment on the consolidated financial statements.

In March 2016, the FASB issued amendments which simplify several aspects of the accounting for share-based payment transactions, including income tax consequences, recognition of stock compensation award forfeitures, classification of awards as either equity or liabilities, the calculation of diluted shares outstanding and classification on the statement of cash flows. The most significant change resulting from these amendments is recording all the tax effects related to share-based payments at settlement through the income statement. Under existing guidance, tax benefits in excess of compensation costs ("windfalls") are recorded in equity. Similarly, tax deficiencies below compensation costs ("shortfalls") are recorded in equity to the extent of previous windfalls, while shortfalls in excess of this are recorded to the income statement. Furthermore, the new guidance is expected to increase the dilutive effect of share-based payment awards as a result of no longer assuming that tax benefits are used to purchase our common stock under the treasury method. The amendments also provide an alternative to estimating stock award forfeitures and instead recording at the time of forfeiture. For public business entities, this update is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. The Company plans to adopt the amendments on January 1, 2017. Based on activity in recent years, the Company estimates that tax benefits related to share-based payments will add approximately $0.08 to $0.12 in annual diluted earnings per share for 2017, primarily through a reduction in IDEXX's effective tax rate, partially offset by an increase in diluted shares outstanding resulting from this accounting change. These impacts may vary significantly by quarter based on the timing of actual settlement activity.

In June 2016, the FASB issued amendments that require financial assets measured at amortized cost be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security. Credit losses on available-for-sale securities will be required when the amortized cost is below the fair market value. The amendments in this update are effective for fiscal years beginning after December 15, 2019 and interim periods within those annual periods. Early adoption for fiscal year beginning after December 15, 2018 is permitted. The Company will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first effective reporting period. These amendments are not expected to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued amendments that provide guidance on the statement of cash flows presentation of certain transactions where diversity in practice exists on the classification of certain cash receipts and payment. The effective date will be the first quarter of an entity's fiscal year 2019, with early adoption permitted. The amendment should be adopted using a retrospective transition approach, but may be applied prospectively if retrospective application would be impractible. We are in the process of determining the impact of these amendments on our consolidated financial statements.

In October 2016, the FASB issued an amendment that requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. These amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings at the beginning of the period adopted. Early adoption is permitted in the first interim period of an annual reporting period for which financial statements have not been issued. We are in the process of determining the impact of these amendments on our consolidated financial statements.

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 and nine months ended September 30, 2016, totaled $0.4 million and $26.1 million, respectively, as compared to $0.6 million and $24.4 million for the three and nine months ended September 30, 2015. The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at September 30, 2016 was $44.2 million, which will be recognized over a weighted average period of approximately 1.8 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 Nine Months Ended September 30,

	2016	2015
Expected stock price volatility	25 %	23 %
Expected term, in years	5.7	5.6
Risk-free interest rate	1.2 %	1.5 %
Weighted average fair value of options granted	$ 17.84	$ 19.72

Note 4. marketable securities

The amortized cost and fair value of marketable securities were as follows (in thousands):

As of September 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	$ 142,656	$ 87	$ (63)	$ 142,680
Certificates of deposit	32,149	-	-	32,149
Asset backed securities	29,147	79	-	29,226
Commercial paper	21,826	-	-	21,826
U.S. government bonds	14,112	11	(4)	14,119
Municipal bonds	1,400	2	-	1,402
Total marketable securities	$ 241,290	$ 179	$ (67)	$ 241,402

As of December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	$ 177,810	$ 24	$ (221)	$ 177,613
U.S. government bonds	12,881	-	(10)	12,871
Agency bonds	12,068	-	(3)	12,065
Certificates of deposit	3,500	-	-	3,500
Commercial paper	3,491	-	-	3,491
International government bonds	1,462	-	(3)	1,459
Municipal bonds	1,400	-	(1)	1,399
Treasury bill	1,192	1	-	1,193
Total marketable securities	$ 213,804	$ 25	$ (238)	$ 213,591

As of September 30, 2016, unrealized losses on marketable securities that have been in a continuous loss position for more than twelve months were not material. Our portfolio of marketable securities had an average AA- credit rating as of September 30, 2016. There were no marketable securities that we consider to be other-than-temporarily impaired as of September 30, 2016.

Remaining effective maturities of marketable securities were as follows (in thousands):

As of September 30, 2016	Amortized Cost	Fair Value

Due in one year or less	$ 206,388	$ 206,470
Due after one year through three years	34,902	34,932
	$ 241,290	$ 241,402

Our investment strategy is to buy short-duration marketable securities with a high credit rating. Some of our marketable securities have call features that can effectively shorten the lifespan from the contractual maturity date. We use the effective maturity date to measure the duration of the marketable securities.

Note 5. 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):

	September 30, 2016	December 31, 2015
Raw materials	$ 30,273	$ 31,184
Work-in-process	16,153	18,698
Finished goods	122,042	138,951
Inventories	$ 168,468	$ 188,833

Note 6. Goodwill and Intangible Assets, NET

The increase in goodwill during the nine months ended September 30, 2016, resulted from changes in foreign currency exchange rates. The decrease in intangible assets other than goodwill during the nine months ended September 30, 2016, resulted primarily from the continued amortization of our intangible assets and an impairment charge related to our OPTI® Medical line of business, partly offset by changes in foreign currency exchange rates.

During the first half of 2016, management reviewed the OPTI Medical product offerings. As a result of this review, we discontinued our product development activities in the human point-of-care medical diagnostics market during March 2016 and focused our commercial efforts in this market on supporting our latest generation OPTI CCA-TS2 Blood Gas and Electrolyte Analyzer. Management identified unfavorable trends in our OPTI Medical line of business resulting from this change in strategy. We revised our forecasts downward, causing us to assess the realizability of the related tangible and intangible assets and determined the expected future cash flows were less than the carrying value of the OPTI Medical asset group. Non-cash intangible asset impairments of $2.2 million were recorded within our condensed consolidated statement of operations within general and administration expenses during the first half of 2016. The intangibles associated with our OPTI Medical human point-of-care medical diagnostics market are fully written off.

NOTE 7. Other current and long-term ASSETS

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

	September 30, 2016	December 31, 2015
Prepaid expenses	$ 23,362	$ 27,244
Taxes receivable	12,859	11,792
Customer acquisition costs, net	17,202	16,412
Other assets	10,034	6,621
Other current assets	$ 63,457	$ 62,069

Other long-term assets consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Investment in long-term product supply arrangements	$ 11,523	$ 12,165
Customer acquisition costs, net	46,667	43,570
Other assets	35,898	29,755
Other long-term assets	$ 94,088	$ 85,490

Note 8. Accrued liabilities

Accrued liabilities consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Accrued expenses	$ 60,098	$ 65,665
Accrued employee compensation and related expenses	74,220	77,027
Accrued taxes	21,542	18,963
Accrued customer programs	46,214	43,875
Accrued liabilities	$ 202,074	$ 205,530

Note 9. Repurchases of common STOCK

We primarily acquire shares by 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 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 and nine months ended September 30, 2016 and 2015 was not material.

The following is a summary of our open market common stock repurchases, reported on a trade date basis, and shares acquired through employee surrender for the three and nine months ended September 30, 2016 and 2015 (in thousands, except per share amounts):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Shares repurchased1	142	1,213	1,119	4,345
Shares acquired through employee surrender1	2	2	56	66
Total shares repurchased1	144	1,215	1,175	4,411
Cost of shares repurchased	$ 15,260	$ 85,975	$ 88,235	$ 313,083
Cost of employee surrenders	218	138	3,950	5,199
Total cost of shares repurchased	$ 15,478	$ 86,113	$ 92,185	$ 318,282
Average cost per share	$ 107.46	$ 70.89	$ 78.43	$ 72.15

(1) Shares repurchased and acquired through employee surrender for payment of minimum required withholding taxes on and before June 15, 2015 and the associated average cost per share have been adjusted to reflect the June 15, 2015 two-for-one stock split. Actual shares repurchased were approximately 2,962,000 for the nine months ended September 30, 2015.

Note 10. Income Taxes

Our effective income tax rate was 30.8 percent for the three months ended September 30, 2016, and 30.7 percent for the nine months ended September 30, 2016. Our effective tax rate was 31.8 percent for the three months ended September 30, 2015, and 30.8 percent for the nine months ended September 30, 2015. The decrease in our effective tax rate for the three and nine months ended September 30, 2016, as compared to the same period in the prior year, was related to the availability of the U.S. R&D tax credit, which was not available during the nine months ending September 30, 2015, as the credit had not yet been extended. In December 2015, the R&D tax credit was permanently extended with retroactive application to January 1, 2015. As a result, we fully recognized the related 2015 tax benefit entirely in the fourth quarter of 2015. These favorable factors were offset by a shift in earnings mix in 2016, with relatively higher earnings subject to domestic tax rates as opposed to lower international tax rates, including the impact of foreign currency exchange rates.

Note 11. ACCUMULATED OTHER Comprehensive Income

The changes in accumulated other comprehensive income ("AOCI"), net of tax, for the nine months ended September 30, 2016 consisted of the following (in thousands):

For the Nine Months Ended September 30, 2016	Unrealized (Loss) Gain on Investments, Net of Tax	Unrealized Gain (Loss) on Derivative Instruments, Net of Tax	Unrealized Gain (Loss) on Net Investment Hedge, Net of Tax	Cumulative Translation Adjustment	Total
Balance as of December 31, 2015	$ (225)	$ 2,217	$ 1,894	$ (46,151)	$ (42,265)
Other comprehensive income (loss) before reclassifications	334	(1,570)	(1,649)	10,873	7,988
Gains reclassified from accumulated other comprehensive income	-	(804)	-	-	(804)
Balance as of September 30, 2016	$ 109	$ (157)	$ 245	$ (35,278)	$ (35,081)

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The following is a summary of reclassifications out of AOCI for the three and nine months ended September 30, 2016 and 2015 (in thousands):

Details about AOCI Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified from AOCI For the Three Months Ended September 30, 2016	2015
Gains (losses) on derivative instruments classified as cash flow hedges included in net income:			
Foreign currency exchange contracts	Cost of revenue	$ 648	$ 5,003
Interest rate swaps	Interest expense	-	(260)
	Total gains before tax	648	4,743
	Tax expense	197	1,374
	Gains, net of tax	$ 451	$ 3,369

Details about AOCI Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified from AOCI For the Nine Months Ended September 30, 2016	2015
Gains on derivative instruments classified as cash flow hedges included in net income:			
Foreign currency exchange contracts	Cost of revenue	$ 1,538	$ 14,547
Interest rate swaps	Interest expense	(421)	(787)
	Total gains before tax	1,117	13,760
	Tax expense	313	4,079
	Gains, net of tax	$ 804	$ 9,681

Note 12. 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 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 2015 Annual Report for additional information regarding deferred stock units.

The following is a reconciliation of weighted average shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Shares outstanding for basic earnings per share	89,894	91,944	89,881	93,194
Shares outstanding for diluted earnings per share:				
Shares outstanding for basic earnings per share	89,894	91,944	89,881	93,194
Dilutive effect of share-based payment awards	1,244	953	1,079	1,068
	91,138	92,897	90,960	94,262

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 and nine months ended September 30, 2016 and 2015 (in thousands):

	For the Three Months Ended			For the Nine Months Ended	
	September 30,			September 30,	
	2016		2015	2016	2015
Weighted average number of shares underlying anti-dilutive options	$	-	752	520	720
Weighted average number of shares underlying anti-dilutive restricted stock units	-		-	-	2

Note 13. Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at September 30, 2016 are consistent with those discussed in Note 14 to the consolidated financial statements in our 2015 Annual Report.

Note 14. 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 (“CODM”), or decision-making group, in deciding how to allocate resources and in assessing performance. Our CODM 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 products and services 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 combines and presents products for the human point-of-care medical diagnostics market with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

Certain costs are not allocated to our operating segments and are instead reported under the caption “Unallocated Amounts”. These costs include costs that do not align with one of our existing operating segments or are cost prohibitive to allocate, which primarily consist of our R&D function, regional or country expenses, certain foreign currency revaluation gains and losses on monetary balances in currencies other than our subsidiaries’ functional currency and unusual items. Corporate support function costs (such as information technology, facilities, human resources, finance and legal), health benefits and incentive compensation are charged to our business segments at pre-determined budgeted amounts or rates. Differences from these pre-determined budgeted amounts or rates are captured within Unallocated Amounts.

Effective January 1, 2016, we modified our management reporting to the CODM to provide a more comprehensive view of the performance of our operating segments by including the capitalization of variances between standard and actual manufacturing costs, which adjusts the timing of cost recognition from when the variance is created to the period in which the related inventory is sold. Prior to January 1, 2016, the capitalization and subsequent recognition of these variances were not allocated to our operating segments and were instead reported under the caption “Unallocated Amounts.”

The segment gross profit and income (loss) from operations within this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2015, has been retrospectively revised to reflect the changes to our segment performance metrics described above.

The following is a summary of segment performance for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	For the Three Months Ended September 30,					
	CAG	Water	LPD	Other	Unallocated Amounts	Consolidated Total
2016						
Revenue	$ 385,288	$ 27,862	$ 29,799	$ 5,359	$ -	$ 448,308
Income (loss) from operations	$ 77,493	$ 12,442	$ 3,026	$ 1,008	$ (5,510)	$ 88,459
Interest expense, net						(6,935)
Income before provision for income taxes						81,524
Provision for income taxes						25,072
Net income						56,452
Less: Net loss attributable to noncontrolling interest						(3)
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 56,455
2015						
Revenue	$ 344,081	$ 25,957	$ 30,448	$ 5,901	$ -	$ 406,387
Income (loss) from operations	$ 61,483	$ 12,642	$ 6,061	$ 569	$ (8,860)	$ 71,895
Interest expense, net						(7,066)
Income before provision for income taxes						64,829
Provision for income taxes						20,600
Net income						44,229
Less: Net income attributable to noncontrolling interest						6
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 44,223

	For the Nine Months Ended September 30,					
	CAG	Water	LPD	Other	Unallocated Amounts	Consolidated Total
2016						
Revenue	$ 1,143,150	$ 79,243	$ 93,511	$ 16,523	$ -	$ 1,332,427
Income (loss) from operations	$ 229,858	$ 34,864	$ 12,665	$ (749)	$ (10,224)	$ 266,414
Interest expense, net						(21,695)
						244,719

Income before provision for income taxes						
Provision for income taxes						75,036
Net income						169,683
Less: Net income attributable to noncontrolling interest						7
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 169,676
2015						
Revenue	$ 1,020,232	$ 72,706	$ 93,777	$ 15,492	$ -	$ 1,202,207
Income (loss) from operations	$ 183,086	$ 33,954	$ 19,596	$ (686)	$ (2,949)	$ 233,001
Interest expense, net						(19,645)
Income before provision for income taxes						213,356
Provision for income taxes						65,611
Net income						147,745
Less: Net income attributable to noncontrolling interest						16
Net income attributable to IDEXX Laboratories, Inc. stockholders						$ 147,729

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The following is a summary of revenue by product and service category for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
CAG segment revenue:				
CAG Diagnostics recurring revenue:	$ 324,233	$ 290,502	$ 968,041	$ 869,413
IDEXX VetLab® consumables	113,963	98,957	336,483	298,093
IDEXX VetLab service and accessories	14,878	13,675	43,461	41,223
Rapid assay products	48,720	47,534	147,583	143,353
Reference laboratory diagnostic and consulting services	146,672	130,336	440,514	386,744
CAG Diagnostics capital - instruments	31,625	25,989	87,119	70,166
Veterinary software, services and diagnostic imaging systems (1)	29,430	27,590	87,990	80,653
CAG segment revenue	385,288	344,081	1,143,150	1,020,232
Water segment revenue	27,862	25,957	79,243	72,706
LPD segment revenue	29,799	30,448	93,511	93,777
Other segment revenue	5,359	5,901	16,523	15,492
Total revenue	$ 448,308	$ 406,387	$ 1,332,427	$ 1,202,207

(1) During the second quarter of 2016, we renamed our customer information management and diagnostic imaging systems product and service category in the CAG segment to veterinary software, services and diagnostic imaging systems. Financial results were not adjusted as a result of this name change.

Note 15. 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 nine months ended September 30, 2016.

Our marketable debt securities are initially valued at the transaction price and are subsequently remeasured to fair value as of the balance sheet date utilizing third-party pricing services. The pricing services utilize industry standard valuation models, including both income and market-based approaches and observable market inputs to determine value. Observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers and other industry and economic events. We validate the prices provided by our third-party pricing services by obtaining independent market values from other pricing sources and analyzing pricing data in certain instances.

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.

At December 31, 2015, we measured 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. As of September 30, 2016, we have no outstanding interest rate swap agreements.

The amounts outstanding under our unsecured revolving credit facility (“Credit Facility” or “line of credit”) and senior notes (“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 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. The estimated fair value of our Credit Facility approximates its carrying value. The estimated fair value and carrying value of our long-term debt were $639.0 million and $599.7 million, respectively, as of September 30, 2016, and $593.7 million and $597.1 million, respectively, as of December 31, 2015.

The following tables set forth our assets and liabilities that were measured at fair value on a recurring basis at September 30, 2016 and at December 31, 2015 by level within the fair value hierarchy (in thousands):

As of September 30, 2016	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, 2016
Assets				
Money market funds(1)	$ 7,532	$ -	$ -	$ 7,532
Commercial paper(1)	-	1,000	-	1,000
Marketable Securities				