SURMODICS INC
Form 10-Q
February 05, 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 December 31, 2015

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________ to ______________

Commission File Number: 0-23837

SurModics, Inc.

(Exact name of registrant as specified in its charter)

MINNESOTA	41-1356149
(State of incorporation)	(I.R.S. Employer Identification No.)

9924 West 74th Street

Eden Prairie, Minnesota 55344

(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (952) 500-7000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically 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 x No o

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

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

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

The number of shares of the registrant’s Common Stock, $.05 par value per share, outstanding as of January 29, 2016 was 12,996,040.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SurModics, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)	December 31, 2015 (Unaudited)	September 30, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$42,668	$ 55,588
Restricted cash	786	—
Accounts receivable, net of allowance for doubtful accounts of $10 and $10 as of December 31, 2015 and September 30, 2015, respectively	5,522	7,478
Inventories	3,301	2,979
Deferred tax assets	—	546
Prepaids and other	961	1,198
Total Current Assets	53,238	67,789
Property and equipment, net	13,506	12,968
Deferred tax assets	6,497	6,704
Intangible assets, net	16,502	2,760
Goodwill	21,822	8,010
Other assets, net	650	479
Total Assets	$112,215	$ 98,710
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$1,052	$ 781
Accrued liabilities:		
Compensation	1,297	2,772
Accrued other	1,529	794
Business combination consideration payable	1,558	305
Deferred revenue	172	48
Total Current Liabilities	5,608	4,700
Contingent consideration	9,308	—
Deferred revenue, less current portion	208	217
Other long-term liabilities	1,818	1,920
Total Liabilities	16,942	6,837
Commitments and Contingencies (Note 16)		
Stockholders’ Equity:		
Series A Preferred stock- $.05 par value, 450,000 shares authorized; no shares issued and outstanding	—	—
Common stock- $.05 par value, 45,000,000 shares authorized; 12,996,040 and 12,945,157 shares issued and outstanding, respectively	650	647
Additional paid-in capital	3,538	3,060

Accumulated other comprehensive income	411	5
Retained earnings	90,674	88,161
Total Stockholders' Equity	95,273	91,873
Total Liabilities and Stockholders' Equity	$112,215	$ 98,710

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

SurModics, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(In thousands, except per share data)	Three Months Ended December 31, 2015 (Unaudited)	2014
Revenue:		
Royalties and license fees	$7,954	$7,275
Product sales	7,181	5,847
Research and development	1,406	1,083
Total revenue	16,541	14,205
Operating costs and expenses:		
Product costs	2,366	1,902
Research and development	3,634	3,576
Selling, general and administrative	3,648	3,542
Acquisition transaction, integration and other costs	2,491	—
Intangible asset amortization	354	151
Contingent consideration accretion expense	109	—
Total operating costs and expenses	12,602	9,171
Operating income	3,939	5,034
Other (loss) income:		
Investment income, net	1	57
Foreign exchange loss	(135)	—
Other loss, net	—	(7)
Other (loss) income, net	(134)	50
Income before income taxes	3,805	5,084
Income tax provision	(1,292)	(1,470)
Net income	$2,513	$3,614
Basic net income per share	$0.19	$0.27
Diluted net income per share	$0.19	$0.27
Weighted average number of shares outstanding:		
Basic	12,966	13,225
Diluted	13,186	13,423

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

SurModics, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(In thousands)	Three Months Ended December 31, 2015 (Unaudited)	2014
Net income	$2,513	$3,614
Other comprehensive income (loss), net of tax:		
Unrealized holding losses on available-for-sale securities arising during the period	(2)	(1,089)
Reclassification adjustment for realized gains included in net income	—	7
Foreign currency translation adjustments	408	—
Other comprehensive income (loss)	406	(1,082)
Comprehensive income	$2,919	$2,532

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

SurModics, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)	Three Months Ended December 31, 2015	2014
	(Unaudited)	
Operating Activities:		
Net income	$2,513	$3,614
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	909	683
Stock-based compensation	684	525
Contingent consideration accretion and unrealized foreign exchange loss	244	—
Deferred taxes	753	1,025
Loss on sales of available-for-sale securities and strategic investments	—	7
Excess tax benefit from stock-based compensation plans	(140)	(453)
Other	(3)	(39)
Change in operating assets and liabilities, net of acquisition:		
Accounts receivable	2,194	309
Inventories	(83)	(12)
Prepaids and other	(75)	(34)
Accounts payable and accrued liabilities	(1,354)	(508)
Income taxes	496	413
Net cash provided by operating activities from continuing operations	6,138	5,530
Investing Activities:		
Purchases of property and equipment	(384)	(41)
Cash proceeds from sales of property and equipment	—	41
Payments for acquisition, net of cash acquired	(18,166)	—
Purchases of available-for-sale securities	—	(3,252)
Sales and maturities of available-for-sale securities	—	973
Cash transferred to discontinued operations	—	(45)
Net cash used in investing activities from continuing operations	(18,550)	(2,324)
Financing Activities:		
Excess tax benefit from stock-based compensation plans	140	453
Issuance of common stock	10	115
Repurchase of common stock	—	(20,000)
Purchase of common stock to pay employee taxes	(353)	(725)
Payment of contingent consideration	(305)	—
Net cash used in financing activities from continuing operations	(508)	(20,157)
Net cash used in continuing operations	(12,920)	(16,951)
Discontinued Operations:		
Net cash used in operating activities	—	(45)
Net cash provided by financing activities	—	45
Net cash provided by discontinued operations	—	—
Net change in cash and cash equivalents	(12,920)	(16,951)
Cash and Cash Equivalents:		

Beginning of period	55,588	43,511
End of period	$42,668	$26,560
Supplemental Information:		
Cash paid for income taxes	$42	$31
Noncash transactions from investing and financing activities:		
Acquisition of property and equipment on account	$54	$12
Contingent consideration and debt assumed in Creagh Medical transaction	$9,857	$—
Issuance of performance shares, restricted and deferred stock units	$1,073	$2,063

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

SurModics, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

Period Ended December 31, 2015

(Unaudited)

1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S.”) (“GAAP”) and, in the opinion of management, reflect all adjustments, consisting of normal recurring adjustments, needed to fairly present the financial results of SurModics, Inc. and subsidiaries (“SurModics” or the “Company”) for the periods presented. These financial statements include some amounts that are based on management’s best estimates and judgments. These estimates may be adjusted as more information becomes available, and any adjustment could be significant. The impact of any change in estimates is included in the determination of net income in the period in which the change in estimate is identified. The results of operations for the three months ended December 31, 2015 are not necessarily indicative of the results that may be expected for the entire 2016 fiscal year.

In accordance with the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”), the Company has omitted footnote disclosures that would substantially duplicate the disclosures contained in the audited consolidated financial statements of the Company. These unaudited condensed consolidated financial statements should be read together with the audited consolidated financial statements for the fiscal year ended September 30, 2015, and footnotes thereto included in the Company’s Form 10-K as filed with the SEC on December 4, 2015.

2. New Accounting Pronouncements

Accounting Standards to be Implemented

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Codification (“ASC”) Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). Principles of this guidance require entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This accounting standard will be effective for the Company beginning in the first quarter of fiscal year 2019 (October 1, 2018) using one of two prescribed retrospective methods. The Company is currently evaluating the impact that the adoption of this standard will have on the Company’s results of operations, cash flows and financial position.

Accounting Standards Implemented

In September 2015, the FASB issued Accounting Standards Update (“ASU”) 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The update requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined, including the cumulative effect of the change in provisional amounts as if the accounting had been completed at the acquisition date. The adjustments related to previous reporting periods since the acquisition date must be disclosed by income statement line item either on the face of the income statement or in the notes. ASU 2015-16 is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years, with early adoption permitted. The Company adopted the ASU in the first quarter of fiscal 2016 without any material impact on the Company’s financial position or financial results.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which eliminates the current requirement to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, entities will be required to classify all deferred tax assets and liabilities as noncurrent. This ASU will be effective for the Company beginning in its first quarter of fiscal year 2018 and early implementation is permitted using either the prospectively or retroactive adoption method. The Company prospectively adopted this ASU in the first quarter of fiscal 2016.

No other new accounting pronouncement issued or effective has had, or is expected to have, a material impact on the Company’s consolidated financial statements.

3. Business Combinations

For all business combinations, the Company records all assets and liabilities of the acquired business, including goodwill and other identified intangible assets, generally at their fair values starting in the period when the acquisition is completed. Contingent consideration, if any, is recognized at its fair value on the acquisition date and changes in fair value are recognized in earnings until settlement. Acquisition-related transaction costs are expensed as incurred.

Creagh Medical Ltd.

On November 20, 2015, the Company acquired 100% of the outstanding common shares and voting shares of Creagh Medical Ltd. (“Creagh Medical”) located in Ballinasloe, Ireland. The results of Creagh Medical’s operations have been included in the Company’s condensed consolidated financial statements as of the Creagh Medical acquisition date. The acquisition was financed with cash on hand. The Company acquired Creagh Medical for up to €30 million (approximately $32 million as of the acquisition date), including an upfront payment of €18 million (approximate as of the acquisition date $19.3 million), and up to €12 million (approximate as of the acquisition date $12.8 million) based on achievement of revenue and value-creating operational milestones through September 30, 2018. The payment of the milestones will occur in the quarter ending December 31, 2018. As of December 31, 2015, the Company has paid $18.5 million in cash for this acquisition, including $0.8 million to an escrow account to fund the repurchase of certain Creagh Medical debt classified securities during fiscal 2016. As these securities have not been legally defeased by the establishment of the escrow fund, the Company has recorded a corresponding restricted cash and business combination consideration payable. It is expected that these securities will be repaid in the third quarter of fiscal 2016. The Company also assumed $0.8 million of debt that was repaid in the second quarter of fiscal 2016 that is also classified as business combination consideration payable on the balance sheet. Total transaction, integration and other costs associated with the Creagh Medical acquisition aggregated $2.4 million for the quarter ended December 31, 2015. Creagh Medical will be included in the Company’s Medical Device reporting segment.

Creagh Medical is a provider of innovative, efficient and cost-effective design and manufacture of high-quality percutaneous transluminal angioplasty (“PTA”) balloon catheters. Since 2006, Creagh Medical has grown its technical and product capability with PTA products approved throughout the world, including Europe, the United States, and Japan. With these resources, the Company is uniquely positioned to offer a total solutions approach from product design and development, through in-house extrusion, balloon forming, top-assembly, packaging and regulatory capabilities to approved products for exclusive distribution. The acquisition is a major step forward in the Company’s strategy to transform its Medical Device segment from being a provider of coatings technologies, to offering whole-product solutions to medical device customers in the large and growing global interventional vascular market.

The purchase price of Creagh Medical consisted of the following:

(Dollars in thousands)	
Cash paid	$18,417
Debt assumed	793
Contingent consideration	9,064
Total purchase price	28,274
Less cash and cash equivalents acquired	(251)
Total purchase price, net of cash acquired	$28,023

The following table summarizes the preliminary allocation of the purchase price to the fair values assigned to the assets acquired and the liabilities assumed at the date of the Creagh Medical acquisition:

	Fair Value	Estimated Useful Life
	(Dollars in thousands)	(In years)

Current assets	$	708	N/A
Property and equipment		634	1.0-10.0
Trade name		75	N/A
Developed technology		1,787	7.0
In-process research and development		942	N/A
Customer relationships		11,119	7.0-10.0
Other noncurrent assets		81	N/A
Current liabilities		(923	)N/A
Deferred tax liabilities		(9	)N/A
Net assets acquired		14,414	
Goodwill		13,609	N/A
Total purchase price, net of cash acquired	$	28,023	

The Creagh Medical goodwill is a result of acquiring and retaining the Creagh Medical existing workforce and expected synergies from integrating their business into SurModics. The goodwill will not be deductible for tax purposes. Purchase accounting is considered preliminary, subject to revision, mainly with respect to working capital, income taxes and goodwill, as final information was not available as of December 31, 2015.

As a result of the Creagh Medical acquisition, the Company has adopted a foreign currency translation policy. Assets and liabilities of non-U.S. dollar functional currency subsidiaries are translated into U.S. dollars at the period-end exchange rates, and revenues and expenses are translated at the average exchange rate for the period. The net effect of these translation adjustments in the condensed consolidated financial statements are recorded as a foreign currency translation adjustment, as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in other, income (loss) net in our Condensed Consolidated Statements of Income.

NorMedix, Inc.

On January 8, 2016, the Company acquired 100% of the shares of NorMedix, Inc. (“NorMedix”), a privately owned design and development company focused on ultra thin-walled, minimally invasive catheter technologies based in Plymouth, Minnesota. The acquisition was financed with cash on hand. The Company acquired NorMedix for $14.0 million, including an upfront payment of $7.0 million, and up to $7.0 million based on achievement of revenue and value-creating operational milestones through September 30, 2019. Contingent consideration associated with the NorMedix transaction is payable as earned. This acquisition strengthens the Company’s vascular device expertise and Research and Development (“R&D) capabilities. This acquisition positions the Company to make significant progress on its strategy to offer whole-product solutions to medical device customers, while continuing its commitment to consistently deliver innovation in coating technologies and in vitro diagnostics. Total transaction, integration and other costs associated with the NorMedix acquisition aggregated $0.1 million for the quarter ended December 31, 2015. NorMedix will be included in the Company’s Medical Device reporting segment. Goodwill associated with this transaction will not be deductible for income tax purposes.

These strategic acquisitions combine the best-in-class capabilities of NorMedix’s catheter-based technologies, Creagh Medical’s PTA balloon platform capabilities, and SurModics’ innovative coating and drug delivery technologies to develop highly differentiated delivery and therapeutic intravascular solutions. The result is an organization with unique device design and development expertise, rich technology content, manufacturing capabilities, and a state-of-the-art facility equipped for medical device R&D and manufacturing.

The purchase price of NorMedix consisted of the following:

(Dollars in thousands)	
Cash paid	$7,000
Contingent consideration	3,740
Total purchase price	10,740
Less cash and cash equivalents acquired	(17)
Total purchase price, net of cash acquired	$10,723

The following table summarizes the allocation of the preliminary purchase price to the fair values assigned to the assets acquired and the liabilities assumed at the date of the NorMedix acquisition:

	Fair Value (Dollars in thousands)	Estimated Useful Life (In years)
Net current assets	$ 46	N/A
Property and equipment	76	N/A
Developed technology	6,850	10.0-14.0
Customer relationships	900	4.0
Deferred tax asset	544	N/A
Other noncurrent asset	12	N/A
Deferred tax liabilities	(2,474)	N/A
Net assets acquired	5,954	
Goodwill	4,769	N/A
Total purchase price, net of cash acquired	$ 10,723	

The NorMedix goodwill is a result of acquiring and retaining the NorMedix existing workforce and expected synergies from integrating their business into SurModics. The goodwill will not be deductible for tax purposes. Purchase accounting is considered preliminary, subject to revision, mainly with respect to working capital, income taxes, intangible asset and contingent consideration valuations, as final information was not available as the filing of this Form 10-Q.

Pro Forma Results

The following unaudited pro forma financial information presents the combined results of operation of the Company as if the acquisitions of Creagh Medical and NorMedix had occurred as of October 1, 2014. The Company has realized $0.5 million of revenue and a loss of $0.3 million from the Creagh Medical operations since it was acquired on November 20, 2015.

The fiscal 2016 pro forma financial information includes adjustments for additional amortization expense on identifiable intangible assets of $0.4 million and contingent consideration accretion expense of $0.3 million, eliminating non-recurring transactional professional fees of $2.5 million, and tax effect impact of $0.3 million.

The fiscal 2015 pro forma financial information includes adjustments for additional amortization expense on identifiable intangible assets of $0.6 million and contingent consideration accretion expense of $0.4 million and tax effect impact of $0.2 million.

The tax impact of the adjustments in all periods reflects no tax benefit from contingent consideration accretion as well as a significant portion of our transaction related costs in fiscal 2016 as they are not deductible for tax purposes. Further, Creagh Medical amortization expense does not reflect an Irish tax benefit as we acquired a net operating loss carryforward as of the acquisition date that was offset in the aggregate by deferred tax liabilities and valuation allowance. Therefore, the amortization of Creagh Medical intangible assets results in a decrease in deferred tax liabilities with a corresponding increase to a deferred tax valuation allowance. NorMedix amortization expense reflects a tax benefit based on our incremental U.S. tax rate.

The unaudited pro forma financial information is not necessarily indicative of what the Company’s consolidated results of operations actually would have been had the acquisition occurred at the beginning of each year. Additionally, the unaudited pro forma financial information does not attempt to project the future results of operations of the combined company.

	Three Months Ended December 31,	
	2015	2014
(In thousands, except per share data)	(Unaudited)	

Revenue	$17,643	$14,796
Net income	$4,189	$2,263
Per share amounts:		
Basic net income per share	$0.32	$0.17
Diluted net income per share	$0.32	$0.17

4. Fair Value Measurements

The accounting guidance on fair value measurements defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The guidance is applicable for all financial assets and financial liabilities and for all nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Fair value is defined as the exchange price that would be received from selling an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and also considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of nonperformance.

Fair Value Hierarchy

Accounting guidance on fair value measurements requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 — Quoted (unadjusted) prices in active markets for identical assets or liabilities.

The Company did not have any Level 1 assets as of December 31, 2015 and September 30, 2015.

Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities 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 asset or liability.

The Company's Level 2 assets for the quarter ended December 31, 2015 consisted of money market funds and commercial paper instruments. Fair market values for these assets are based on quoted vendor prices and broker pricing where all significant inputs are observable. To ensure the accuracy of quoted vendor prices and broker pricing, the Company performs regular reviews of investment returns to industry benchmarks and sample tests of individual securities to validate quoted vendor prices with other available market data.

Level 3 — Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

Included in Level 3 liabilities at December 31, 2015 was a $9.3 million contingent consideration liability related to achievement of revenue and value-creating milestones. There were no Level 3 instruments as of September 30, 2015 or December 31, 2014.

In valuing assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2015:

(Dollars in thousands)	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value as of December 31, 2015
Assets				
Cash equivalents	$ —	$ 33,603	$ —	$ 33,603
Total assets	$ —	$ 33,603	$ —	$ 33,603
Liabilities				
Contingent consideration	$ —	$ —	$ (9,308)	$ (9,308)
Total liabilities	$ —	$ —	$ (9,308)	$ (9,308)

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2015:

(Dollars in thousands)	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value as of September 30, 2015
Assets:				
Cash equivalents	$ —	$ 53,591	$ —	$ 53,591
Total assets measured at fair value	$ —	$ 53,591	$ —	$ 53,591

Included in Level 3 fair value measurements as of December 31, 2015 was a $9.3 million contingent consideration liability related to achievement of revenue and value-creating milestones associated with the Creagh Medical acquisition. The following table summarizes the changes in the contingent consideration liability for the quarter ended December 31, 2015:

(Dollars in thousands)	
Contingent consideration liability at September 30, 2015	$—
Additions	9,064
Fair value adjustments	—
Settlements	—
Interest accretion	109
Foreign currency translation	135
Contingent consideration liability at December 31, 2015	$9,308

Valuation Techniques

The valuation techniques used to measure the fair value of assets are as follows:

Cash equivalents — These assets are classified as Level 2 and are carried at historical cost which is a reasonable estimate of fair value because of the relatively short time between origination of the instrument and its expected realization.

Contingent consideration — The contingent consideration liabilities were determined based on discounted cash flow analyses that included revenue estimates, probability of strategic milestone achievement and a discount rate, which are considered significant unobservable inputs as of the acquisition date and December 31, 2015. For the revenue based milestones, the Company discounted forecasted revenue by 13.9%, which represents the Company's weighted average cost of capital adjusted for the short-term nature of the cash flows. The resulting present value of revenue was used as an input into an option pricing approach, which also considered the Company's risk of non-payment of the revenue-based milestones. Non-revenue milestones are assumed to have an 80-95% probability of achievement and related payments were discounted using the Company's estimated cost of debt, or 5.9%. To the extent that these assumptions were to change, the fair value of the contingent consideration liabilities could change significantly. Included in the condensed consolidated statement of income for the three months ended December 31, 2015 is $0.1 million of expense related to the accretion of the contingent consideration. The €12 million contingent consideration related to the Creagh Medical acquisition is denominated in Euros and is not hedged. The Company recorded a $0.1 million foreign currency exchange loss in the first quarter of fiscal 2016 related to this contingent consideration.

5. Investments

During the year ended September 30, 2015, the Company liquidated its investment portfolio and was invested solely in cash equivalents. Investments made during 2014 consisted principally of U.S. government and government agency obligations, mortgage-backed securities and corporate and municipal debt securities and were classified as available-for-sale at December 31, 2014. Available-for-sale securities were reported at fair value with unrealized gains and losses, net of tax, excluded from the condensed consolidated statements of income and reported in the condensed consolidated statements of comprehensive income as well as a separate component of stockholders' equity in the condensed consolidated balance sheets, except for other-than-temporary impairments, which are reported as a charge to current earnings. A loss would be recognized when there is an other-than-temporary impairment in the fair value of any individual security classified as available-for-sale, with the associated net unrealized loss reclassified out of accumulated other comprehensive income with a corresponding adjustment to other income. This adjustment results in a new cost basis for the investment. Interest earned on debt securities, including amortization of premiums and accretion of discounts, is included in other income. Realized gains and losses from the sales of debt securities, which are included in other income, are determined using the specific identification method.

During the year ended September 30, 2015, the Company liquidated its investment portfolio to support corporate initiatives, as a result the ending balance of available-for-sale investments at December 31, 2015 was zero.

The following table summarizes sales of available-for-sale debt securities:

(Dollars in thousands)	Three Months Ended December 31, 2015	2014
Proceeds from sales	$ —	$ 973
Gross realized gains	$ —	$ —
Gross realized losses	$ —	$ (7)

12

6. Inventories

Inventories are principally stated at the lower of cost or market using the specific identification method and include direct labor, materials and overhead, with cost of product sales determined on a first-in, first-out basis. Inventories consisted of the following components:

(Dollars in thousands)	December 31, 2015	September 30, 2015
Raw materials	$ 1,221	$ 1,264
Finished products	2,080	1,715
Total	$ 3,301	$ 2,979

7. Other Assets

Other assets consist principally of the following:

(Dollars in thousands)	December 31, 2015	September 30, 2015
ViaCyte, Inc.	$ 479	$ 479
Other noncurrent assets	171	—
Other assets, net	$ 650	$ 479

The Company has invested a total of $5.3 million in ViaCyte, Inc. (“ViaCyte”), a privately-held California-based biotechnology firm that is developing a unique treatment for diabetes using coated islet cells, the cells that produce insulin in the human body. The balance of the investment of $0.5 million, which is net of previously recorded other-than-temporary impairments of $4.8 million is accounted for under the cost method and represents less than a 1% ownership interest. The Company does not exert significant influence over ViaCyte’s operating or financial activities.

The carrying value of each cost method investment is reviewed quarterly for changes in circumstances or the occurrence of events that suggest the Company’s investment may not be recoverable. The fair value of cost method investments is not adjusted if there are no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment.

8. Intangible Assets

Intangible assets consist principally of acquired patents and technology, customer relationships, licenses and trademarks. During the three months ended December 31, 2015, the Company acquired 100% of the shares of Creagh Medical. The Company recorded amortization expense of $0.4 million and $0.2 million for the three months ended

December 31, 2015 and 2014, respectively.

Intangible assets consisted of the following:

	December 31, 2015			
(Dollars in thousands)	Weighted Average Original Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Definite-lived intangible assets:				
Customer lists and relationships	7.0-10.0	$ 16,417	$ (4,674)	$ 11,743
Core technology	8.0	530	(530)	—
Developed technology	7.0	1,814	(29)	1,785
Non-compete	5.0	230	(23)	207
Patents and other	16.8	2,321	(1,166)	1,155
Subtotal		21,312	(6,422)	14,890
Unamortized intangible assets:				
In-process research and development		956	—	956
Trademarks and trade names		656	—	656
Total		$ 22,924	$ (6,422)	$ 16,502

	September 30, 2015			
(Dollars in thousands)	Weighted Average Original Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Definite-lived intangible assets:				
Customer lists	9.0	$ 5,132	$ (4,363)	$ 769
Core technology	8.0	530		