HAEMONETICS CORP
Form 10-Q
November 06, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarter ended: September 29, 2018
Commission File Number: 001-14041
HAEMONETICS CORPORATION
(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	04-2882273 (I.R.S. Employer Identification No.)

400 Wood Road, Braintree, MA 02184
(Address of principal executive offices)
Registrant’s telephone number, including area code: (781) 848-7100

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares of $0.01 par value common stock outstanding as of November 2, 2018: 51,684,326

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ITEM 1. FINANCIAL STATEMENTS

HAEMONETICS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Net revenues	$241,581	$ 225,377	$470,928	$436,328
Cost of goods sold	129,674	120,815	275,777	240,101
Gross profit	111,907	104,562	195,151	196,227
Operating expenses:				
Research and development	8,583	7,521	17,989	15,714
Selling, general and administrative	77,248	72,783	145,793	139,644
Total operating expenses	85,831	80,304	163,782	155,358
Operating income	26,076	24,258	31,369	40,869
Gain on divestiture	—	—	—	8,000
Interest and other expense, net	(3,039)	(1,397)	(5,017)	(2,756)
Income before provision for income taxes	23,037	22,861	26,352	46,113
Provision for income taxes	4,311	2,759	10,445	5,874
Net income	$18,726	$ 20,102	$15,907	$40,239
Net income per share - basic	$0.36	$ 0.38	$0.31	$0.77
Net income per share - diluted	$0.35	$ 0.38	$0.30	$0.76
Weighted average shares outstanding				
Basic	51,605	52,619	51,862	52,531
Diluted	53,138	52,981	53,365	52,896
Comprehensive income	$18,403	$ 21,937	$10,865	$45,703

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

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HAEMONETICS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	September 29, 2018 (Unaudited)	March 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 199,763	$ 180,169
Accounts receivable, less allowance of $3,253 at September 29, 2018 and $2,111 at March 31, 2018	161,590	151,226
Inventories, net	163,584	160,799
Prepaid expenses and other current assets	27,868	28,983
Total current assets	552,805	521,177
Property, plant and equipment, net	344,560	332,156
Intangible assets, less accumulated amortization of $264,742 at September 29, 2018 and $249,278 at March 31, 2018	141,483	156,589
Goodwill	210,844	211,395
Deferred tax asset	3,765	3,961
Other long-term assets	12,254	12,061
Total assets	$ 1,265,711	$ 1,237,339
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and current maturities of long-term debt	$ 12,664	$ 194,259
Accounts payable	57,857	55,265
Accrued payroll and related costs	49,132	69,519
Other liabilities	69,514	65,660
Total current liabilities	189,167	384,703
Long-term debt, net of current maturities	330,988	59,423
Deferred tax liability	13,235	6,526
Other long-term liabilities	30,983	34,258
Total stockholders' equity		
Common stock, $0.01 par value; Authorized — 150,000,000 shares; Issued and outstanding — 51,624,719 shares at September 29, 2018 and 52,342,965 shares at March 31, 2018	516	523
Additional paid-in capital	530,480	503,955
Retained earnings	194,375	266,942
Accumulated other comprehensive loss	(24,033)	(18,991)
Total stockholders' equity	701,338	752,429
Total liabilities and stockholders' equity	$ 1,265,711	$ 1,237,339

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

HAEMONETICS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited in thousands)

	Six Months Ended	
	September 29, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net income	$15,907	$ 40,239
Adjustments to reconcile net income to net cash provided by operating activities:		
Non-cash items:		
Depreciation and amortization	51,692	43,986
Impairment of assets	21,170	—
Stock-based compensation expense	7,961	4,199
Gain on divestiture	—	(8,000)
Provision for losses on accounts receivable and inventory	549	688
Other non-cash operating activities	1,277	312
Change in operating assets and liabilities:		
Change in accounts receivable	(13,326)	10,739
Change in inventories	(3,912)	7,284
Change in prepaid income taxes	(349)	776
Change in other assets and other liabilities	4,095	3,920
Change in accounts payable and accrued expenses	(4,585)	(6,815)
Net cash provided by operating activities	80,479	97,328
Cash Flows from Investing Activities:		
Capital expenditures	(76,002)	(29,125)
Proceeds from divestiture	—	9,000
Proceeds from sale of property, plant and equipment	656	1,346
Net cash used in investing activities	(75,346)	(18,779)
Cash Flows from Financing Activities:		
Term loan borrowings	347,780	—
Repayment of term loan borrowings	(258,103)	(28,455)
Proceeds from employee stock purchase plan	1,780	1,622
Proceeds from exercise of stock options	7,127	10,120
Share repurchases	(80,000)	—
Other financing activities	—	417
Net cash provided by (used in) financing activities	18,584	(16,296)
Effect of exchange rates on cash and cash equivalents	(4,123)	1,805
Net Change in Cash and Cash Equivalents	19,594	64,058
Cash and Cash Equivalents at Beginning of Period	180,169	139,564
Cash and Cash Equivalents at End of Period	$199,763	$ 203,622
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$5,833	$ 3,768
Income taxes paid	$5,053	$ 5,449
Transfers from inventory to fixed assets for placement of Haemonetics equipment	$12,099	$ 3,965

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

HAEMONETICS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited consolidated financial statements of Haemonetics Corporation ("Haemonetics" or the "Company") presented herein have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. All intercompany transactions have been eliminated. Operating results for the six months ended September 29, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year ending March 30, 2019 or any other interim period. The Company has assessed its ability to continue as a going concern. As of September 29, 2018, the Company has concluded that substantial doubt about its ability to continue as a going concern does not exist. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the annual report on Form 10-K for the fiscal year ended March 31, 2018.

The Company considers events or transactions that occur after the balance sheet date but prior to the issuance of the financial statements to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. The Company had no significant subsequent events.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Standards Implemented

Revenue from Contracts with Customers (Topic 606)

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). ASC Update No. 2014-09 stipulates that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, an entity should apply the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

In March 2016, the FASB issued ASC Update No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net). The purpose of ASC Update No. 2016-08 is to clarify the guidance on principal versus agent considerations. It includes indicators that help to determine whether an entity controls the specified good or service before it is transferred to the customer and to assist in determining when the entity satisfied the performance obligation and as such, whether to recognize a gross or a net amount of consideration in its consolidated statement of operations.

In April 2016, the FASB issued ASC Update No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. The guidance clarifies that entities are not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. ASC Update No. 2016-10 also addresses how to determine whether promised goods or services are separately identifiable and permits entities to make a policy election to treat shipping and handling costs as fulfillment activities. In addition, it clarifies key provisions in Topic 606 related to licensing.

The Company adopted ASU 2014-09 on April 1, 2018 using the modified retrospective method. Under this method, entities recognize the cumulative effect of applying the new standard at the date of initial application with no restatement of comparative periods presented. The cumulative effect of applying the new standard resulted in an increase to opening retained earnings of $1.5 million upon adoption of Topic 606 in April 2018, primarily related to deferred revenue associated with software contracts. Software revenue accounted for approximately 7.9% and 8.0% of total revenue for the three and six months ended September 29, 2018, respectively, and for approximately 8.5% and 8.4% of total revenue for the three and six months ended September 30, 2017, respectively. The new standard has been applied only to those contracts that were not completed as of March 31, 2018. The impact of adopting ASU 2014-09 was not significant to individual financial statement line items in the consolidated balance sheet and consolidated statement of income and comprehensive income.

Other Recent Accounting Pronouncements

In October 2016, the FASB issued ASC Update No. 2016-16, Income Taxes (Topic 740). The guidance requires companies to recognize the income tax effects of intercompany sales and transfers of assets, other than inventory, in the income statement as income tax expense (or benefit) in the period in which the transfer occurs. The Company adopted ASC Update No. 2016-16 during the first quarter of fiscal 2019. The adoption of ASC Update No. 2016-16 did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASC Update No. 2016-15, Statement of Cash Flow (Topic 230). The guidance reduces diversity in how certain cash receipts and cash payments are presented and classified in the consolidated statements of cash flows. The Company adopted ASC Update No. 2016-15 during the first quarter of fiscal 2019. The adoption of ASC Update No. 2016-15 did not have a material impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASC Update No. 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting (Topic 718). The guidance clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. The Company adopted ASC Update No. 2017-09 during the first quarter of fiscal 2019. The adoption of ASC Update No. 2017-09 did not have a material impact on the Company's consolidated financial statements.

In August 2017, the FASB issued ASC Update No. 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (Topic 815). The new guidance makes more financial and non-financial hedging strategies eligible for hedge accounting, amends the presentation and disclosure requirements for hedging activities and changes how companies assess hedge effectiveness. The Company early adopted ASC Update No. 2017-12 during the second quarter of fiscal 2019. The adoption of ASC Update No. 2017-12 did not have an impact on the Company's consolidated financial statements or the classification of its designated and non-designated hedge contracts.

3. RESTRUCTURING

On an ongoing basis, the Company reviews the global economy, the healthcare industry, and the markets in which it competes to identify opportunities for efficiencies, enhance commercial capabilities, align its resources and offer its customers better solutions. In order to realize these opportunities, the Company undertakes restructuring-type activities to transform its business.

During fiscal 2018, the Company launched a Complexity Reduction Initiative (the "2018 Program"), a company-wide restructuring program designed to improve operational performance and reduce cost, freeing up resources to invest in accelerated growth. This program includes a reduction of headcount and operating costs which will enable a more streamlined organizational structure. The Company expects to incur aggregate charges between $50 million and $60 million associated with these actions, of which it expects $35 million to $40 million will consist of severance and other employee costs and the remainder will consist of other exit costs, primarily related to third party services. These charges, substantially all of which will result in cash outlays, will be incurred as the specific actions required to execute on these initiatives are identified and approved and are expected to continue through fiscal 2020. During the three and six months ended September 29, 2018, the Company incurred $1.9 million and $5.3 million, respectively, of restructuring and turnaround costs under this program. Total cumulative charges under this program are $41.9 million.

During fiscal 2017, the Company launched a restructuring program (the "2017 Program") designed to reposition its organization and improve its cost structure. During the three and six months ended September 29, 2018, there were nominal restructuring and turnaround charges recorded under this program. During the three and six months ended September 30, 2017, the Company incurred $5.2 million and $7.7 million, respectively, of restructuring and turnaround costs under this program. The 2017 Program is substantially complete.

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The following table summarizes the activity for restructuring reserves related to the 2018 Program and the 2017 Program for the six months ended September 29, 2018, substantially all of which relates to employee severance and other employee costs:

(In thousands)	2018 Program	2017 Program	Total
Balance at March 31, 2018	$27,129	$1,406	$28,535
Costs incurred, net of reversals	(382)	57	(325)
Payments	(12,159)	(984)	(13,143)
Non-cash adjustments	(96)	—	(96)
Balance at September 29, 2018	$14,492	$479	$14,971

The substantial majority of restructuring costs during the three and six months ended September 29, 2018 have been included as a component of selling, general and administrative expenses in the accompanying consolidated statements of income. As of September 29, 2018, the Company had a restructuring liability of $15.0 million, of which $13.6 million is payable within the next twelve months.

In addition to the restructuring costs included in the table above, during the three and six months ended September 29, 2018, the Company also incurred costs of $2.2 million and $5.8 million, respectively, that do not constitute restructuring under ASC 420, Exit and Disposal Cost Obligations, which it refers to as turnaround costs. These costs, substantially all of which have been included as a component of selling, general and administrative expenses in the accompanying consolidated statements of income, consist primarily of expenditures directly related to the restructuring actions and include program management costs associated with the implementation of outsourcing initiatives and recent accounting standards.

The tables below present restructuring and turnaround costs by reportable segment:

Restructuring costs	Three Months Ended		Six Months Ended	
(In thousands)	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Japan	$91	$ 2	$102	$ 111
EMEA	(5)	15	119	25
North America Plasma	—	—	(40)	—
All Other	(119)	134	(506)	1,071
Total	$(33)	$ 151	$(325)	$ 1,207

Turnaround costs	Three Months Ended		Six Months Ended	
(In thousands)	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Japan	$—	$ —	$—	$ —
EMEA	—	20	28	26
North America Plasma	31	197	41	349
All Other	2,120	5,419	5,723	6,688
Total	$2,151	$ 5,636	$5,792	$ 7,063
Total restructuring and turnaround costs	$2,118	$ 5,787	$5,467	$ 8,270

4. INCOME TAXES

The Company conducts business globally and reports its results of operations in a number of foreign jurisdictions in addition to the United States. The Company's reported tax rate is impacted by the jurisdictional mix of earnings in any given period as the foreign jurisdictions in which it operates have tax rates that differ from the U.S. statutory tax rate.

The Company's reported tax rate for the three and six months ended September 29, 2018 was 18.7% and 39.6%, respectively. The rate for the three months ended September 29, 2018 includes a discrete stock compensation windfall benefit of $2.6 million. The rate for the six months ended September 29, 2018 is higher than the U.S. statutory tax rate primarily as a result of asset impairment expense of $21.2 million recorded in pretax income for which no tax benefit was recognized as a result of the valuation allowance maintained against its deferred tax assets in the impacted jurisdiction. Refer to Note 8, Property, Plant and Equipment for additional details. The Company's effective tax rate was also negatively impacted by certain provisions of the recently enacted U.S. tax reform as discussed below.

During the three months ended September 29, 2018 and September 30, 2017, the Company reported an income tax provision of $4.3 million and $2.8 million, respectively. During the six months ended September 29, 2018 and September 30, 2017, the Company reported an income tax provision of $10.4 million and $5.9 million, respectively. The change in the Company's tax provision for both the three and six months ended September 29, 2018 was primarily due to an increase in the tax expense of its U.S. entity, which was impacted by the U.S. tax reform provisions discussed in more detail below, partially offset by a discrete stock compensation windfall benefit.

During fiscal 2018, the Tax Cuts and Jobs Act (the "Act") was enacted in the United States. As of September 29, 2018, the Company had not completed its accounting for the tax effects of the enactment of the Act. However, it has made a reasonable estimate of the effects on its existing deferred tax balances and the one-time transition tax. During the three and six months ended September 29, 2018, the Company recognized an immaterial adjustment to the provisional tax expense estimate recorded related to the Act. The Company will continue to refine its calculations as additional analysis is completed. In addition, the Company's estimates may also be affected as it gains a more thorough understanding of the tax law. In the third quarter of fiscal 2019, the Company will finalize its accounting for the tax effects of the Act.

The Company has incorporated the other impacts of the Act that became effective in fiscal 2019 in the calculation of the year to date tax provision and effective tax rate, including the provisions related to Global Intangible Low Taxed Income, Foreign Derived Intangible Income, Base Erosion Anti Abuse Tax, as well as other provisions which limit tax deductibility of expenses.

The Company is in a three year cumulative loss position in the U.S. and, accordingly, maintains a valuation allowance against certain U.S. deferred tax assets. Additionally, the Company also maintains a valuation allowance against certain other deferred tax assets primarily in Switzerland, Puerto Rico, Luxembourg and France which it has concluded are not more-likely-than-not realizable.

5. EARNINGS PER SHARE (“EPS”)

The following table provides a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations.

(In thousands, except per share amounts)	Three Months Ended September 29, 2018	Three Months Ended September 30, 2017	Six Months Ended September 29, 2018	Six Months Ended September 30, 2017
Basic EPS				
Net income	$18,726	$ 20,102	$15,907	$ 40,239
Weighted average shares	51,605	52,619	51,862	52,531
Basic income per share	$0.36	$ 0.38	$0.31	$ 0.77
Diluted EPS				
Net income	$18,726	$ 20,102	$15,907	$ 40,239
Basic weighted average shares	51,605	52,619	51,862	52,531
Net effect of common stock equivalents	1,533	362	1,503	365
Diluted weighted average shares	53,138	52,981	53,365	52,896
Diluted income per share	$0.35	$ 0.38	$0.30	$ 0.76

Basic earnings per share is calculated using the Company's weighted-average outstanding common stock. Diluted earnings per share is calculated using its weighted-average outstanding common stock including the dilutive effect of stock awards as determined under the treasury stock method. For the three and six months ended September 29, 2018, weighted average shares outstanding, assuming dilution, excludes the impact of 0.2 million and 0.1 million anti-dilutive shares, respectively. For the three and six months ended September 30, 2017, weighted average shares outstanding, assuming dilution, excludes the impact of 0.9 million and 0.8 million anti-dilutive shares, respectively.

Share Repurchase Plan
On February 6, 2018, the Company announced that its Board of Directors authorized the repurchase of up to $260 million of its outstanding common stock from time to time, based on market conditions, through March 30, 2019.

In May 2018, the Company completed a $100.0 million repurchase of its common stock pursuant to an accelerated share repurchase agreement ("ASR") entered into with Citibank N.A (“Citibank”) in February 2018. The total number of shares repurchased under the ASR was approximately 1.4 million at an average price per share upon final settlement of $72.51. In August 2018, the Company completed an additional $80.0 million repurchase of its common stock pursuant to an ASR entered into with Citibank in June 2018. The total number of shares repurchased under the ASR was approximately 0.9 million at an average price per share upon final settlement of $93.83.

As of September 29, 2018, the total remaining authorization for repurchases of the Company’s common stock under its share repurchase program was $80.0 million.

6. REVENUE

The Company's revenue recognition policy is to recognize revenues from product sales, software and services in accordance with ASC Topic 606, Revenue from Contracts with Customers. Revenue is recognized when obligations under the terms of a contract with a customer are satisfied; this occurs with the transfer of control of the Company’s goods or services. The Company considers revenue to be earned when all of the following criteria are met: it has a contract with a customer that creates enforceable rights and obligations; promised products or services are identified; the transaction price, or the consideration it expects to receive for transferring goods or providing services, is determinable and it has transferred control of the promised items to the customer. A promise in a contract to transfer a distinct good or service to the customer is identified as a performance obligation. A contract’s transaction price is allocated to each performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Some of the Company’s contracts have multiple performance obligations. For contracts with multiple performance obligations, the Company allocates the contract’s transaction price to each performance obligation based on the estimated standalone selling prices of the good or service in the contract. For goods or services for which observable standalone selling prices are not available, the Company uses an expected cost plus a margin approach to estimate the standalone selling price of each performance obligation.

As of September 29, 2018, the Company had $26.2 million of its transaction price allocated to remaining performance obligations related to executed contracts with an original duration of one year or more. The Company expects to recognize approximately 57% of this amount as revenue within the next twelve months and the remaining balance thereafter.

The Company adopted Topic 606 as of April 1, 2018, using the modified retrospective method. Under this method, entities recognize the cumulative effect of applying the new standard at the date of initial application with no restatement of comparative periods presented. The cumulative effect of applying the new standard resulted in an increase to opening retained earnings of $1.5 million upon adoption of Topic 606 on April 1, 2018, primarily related to deferred revenue associated with software revenue. The new standard has been applied only to those contracts that were not completed as of March 31, 2018.

The impact of adopting Topic 606 was not significant to individual financial statement line items in the consolidated balance sheet as of September 29, 2018 or in the consolidated statements of income and comprehensive income for the three and six months ended September 29, 2018.

Product Revenues

The majority of the Company’s performance obligations related to product sales are satisfied at a point in time. Product sales consist of the sale of its disposable blood component collection and processing sets and the related equipment. The Company’s performance obligation related to product sales is satisfied upon shipment or delivery to the customer based on the specified terms set forth in the customer contract. Shipping and handling activities performed after a customer obtains control of the good are treated as fulfillment activities and are not considered to be a separate performance obligation. Revenue is recognized over time for maintenance plans provided to customers that provide services beyond the Company’s standard warranty period. Payment terms between customers related to product sales vary by the type of customer, country of sale, and the products or services offered and could result in an unbilled receivable or deferred revenue balance depending on whether the performance obligation has been satisfied (or partially satisfied).

For product sales to distributors, the Company recognizes revenue for both equipment and disposables upon shipment to distributors, which is when its performance obligations are complete. The Company's standard contracts with its distributors state that title to the equipment passes to the distributors at point of shipment to a distributor’s location. The distributors are responsible for shipment to the end customer along with any installation, training and acceptance of the equipment by the end customer. Payments from distributors are not contingent upon resale of the product.

The Company also places equipment at customer sites. While the Company retains ownership of this equipment, the customer has the right to use it for a period of time provided they meet certain agreed to conditions. The Company recovers the cost of providing the equipment from the sale of its disposables.

Software and Other Revenues

To a lesser extent, the Company enters into other types of contracts including certain software licensing arrangements to provide software solutions to support its plasma, blood collection and hospital customers. A portion of its software sales are perpetual licenses typically accompanied by significant implementation services related to software customization as well as other professional and technical services. The Company generally recognizes revenue from the sale of perpetual licenses and related customization services over time (the Company is creating or enhancing an asset that the customer controls) using an input method which requires it to make estimates of the extent of progress toward completion of the contract. When the Company provides other services, including in some instances hosting, technical support and maintenance, it recognizes these fees and charges over time (the customer simultaneously receives and consumes benefits), as performance obligations for these services are satisfied during the contract period. Certain of its software licensing arrangements are term-based licenses that include a per-collection or a usage-based fee related to the use of the license and the related technical support and hosting services. For these usage-based arrangements, the Company applies the revenue recognition exception resulting in revenue recognition occurring upon the later of actual usage or satisfaction of the related performance obligations. The payment terms for software licensing arrangements vary by customer pursuant to the terms set forth in the customer contract and result in an unbilled receivable or deferred revenue balance depending on whether the performance obligation has been satisfied (or partially satisfied).

Significant Judgments

Revenues from product sales are recorded at the net sales price, which includes estimates of variable consideration related to rebates, product returns and volume discounts. These reserves are based on estimates of the amounts earned or to be claimed on the related sales. The Company's estimates take into consideration historical experience, current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect the Company’s best estimates of the amount of consideration to which it is entitled based on the terms of the contract. The amount of variable consideration included in the net sales price is limited to the amount that is probable not to result in a significant reversal in the amount of the cumulative revenue recognized in a future period. Revenue recognized in the current period related to performance obligations satisfied in prior periods was not material.

Contract Balances

The timing of revenue recognition, billings and cash collections result in billed accounts receivable, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities) on the consolidated balance sheets. The difference in timing between billing and revenue recognition primarily occurs in software licensing arrangements, resulting in contract assets and contract liabilities.

As of September 29, 2018 and April 1, 2018, the Company had contract assets of $5.2 million and $2.7 million, respectively. The change is primarily due to the delay in billings compared to the revenue recognized. Contract assets are classified as other current assets and other long-term assets on the consolidated balance sheet.

As of September 29, 2018 and April 1, 2018, the Company had contract liabilities of $16.4 million and $16.6 million, respectively. During the three and six months ended September 29, 2018, the Company recognized $4.1 million and $11.5 million, respectively, of revenue that was included in the above April 1, 2018 contract liability balance. Contract liabilities are classified as other current liabilities and other long-term liabilities on the consolidated balance sheet.

Practical Expedients

The Company elected not to disclose the value of transaction price allocated to unsatisfied performance obligations for contracts with an original expected length of one year or less. When applicable, the Company has also elected to use the practical expedient to not adjust the promised amount of consideration for the effects of a significant financing component if it is expected, at contract inception, that the period between when the Company transfers a promised good or service to a customer, and when the customer pays for that good or service, will be one year or less.

7. INVENTORIES

Inventories are stated at the lower of cost or market and include the cost of material, labor and manufacturing overhead. Cost is determined using the first-in, first-out method.

(In thousands)	September 29, 2018	March 31, 2018[1]
Raw materials	$ 51,028	$52,997
Work-in-process	13,075	10,774
Finished goods	99,481	97,028
Total inventories	$ 163,584	$160,799

[1] The Company corrected the classification of inventory as of March 31, 2018. This correction did not change total inventories and did not have a financial statement impact.

8. PROPERTY, PLANT AND EQUIPMENT

As part of the acquisition of the whole blood business from Pall Corporation (“Pall”) in fiscal 2012, Pall agreed to manufacture and install in one of the Company's facilities a filter media manufacturing line (the “HDC line”) for which the Company agreed to pay Pall approximately $15.0 million (plus pre-approved overages). Pall also agreed to supply media to the Company for use in leukoreduction filters until such time as the Company accepted the HDC line.

In May 2018, the Company entered into a long-term supply agreement with Pall under which Pall will continue to supply media to the Company for use in leukoreduction filters. As a condition of the supply agreement, the Company agreed to accept the HDC line and to make a final payment of $9.0 million to Pall for the HDC line.

As a result of the decision to continue to source media for leukoreduction filters from Pall rather than producing them internally, the Company does not expect to utilize the HDC line for future production and expect that the asset’s future cash flows will not be sufficient to recover its carrying value of $19.8 million. Accordingly, during the first quarter of fiscal 2019 the Company recorded impairment charges of $19.8 million for the HDC line.

During the first quarter of fiscal 2019, the Company also impaired $1.4 million of property, plant and equipment as a result of a review of non-core and underperforming assets and a decision to discontinue the use of or investment in certain assets. This impairment, as well as the impairment of the HDC line, were included within cost of goods sold on the consolidated statements of income and impacted the All Other reporting segment.

Additionally, the Company has changed the estimated useful lives of PCS2 devices as these will be replaced by the NexSys PCS™ which the Company began placing during the second quarter of fiscal 2019. During the three and six months ended September 29, 2018, the Company incurred $4.4 million and $8.4 million, respectively, of accelerated depreciation expense related to this change in estimate.

9. CAPITALIZATION OF SOFTWARE DEVELOPMENT COSTS

For costs incurred related to the development of software to be sold, leased or otherwise marketed, the Company applies the provisions of ASC 985-20, Software - Costs of Software to be Sold, Leased or Marketed, which specifies that costs incurred internally in researching and developing a computer software product should be charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, all software costs should be capitalized until the product is available for general release to customers.

The Company capitalized $1.5 million and $6.4 million of software development costs for ongoing initiatives during the six months ended September 29, 2018 and September 30, 2017, respectively. At September 29, 2018 and March 31, 2018, the Company had a total of $73.3 million and $71.8 million of capitalized software costs, respectively, of which $8.6 million and $17.7 million are related to in-process software development initiatives.

During the six months ended September 29, 2018, there were $10.6 million capitalized costs placed into service. The Company did not place any capitalized costs into service during the six months ended September 30, 2017. The costs capitalized for each project are included in intangible assets in the consolidated financial statements.

10. PRODUCT WARRANTIES

The Company generally provides warranty on parts and labor for one year after the sale and installation of each device. The Company also warrants disposables products through their use or expiration. The Company estimates its potential warranty expense based on its historical warranty experience and periodically assesses the adequacy of its warranty accrual, making adjustments as necessary.

(In thousands)	Six Months Ended September 29, 2018	September 30, 2017
Warranty accrual as of the beginning of the period	$ 316	$ 176
Warranty provision	333	796
Warranty spending	(392)	(537)
Warranty accrual as of the end of the period	$ 257	$ 435

11. NOTES PAYABLE AND LONG-TERM DEBT

On June 15, 2018, the Company entered into a credit agreement with certain lenders which provided for a $350.0 million term loan (the "Term Loan") and a $350.0 million revolving loan (the "Revolving Credit Facility" and together with the Term Loan, the "Credit Facilities"). The Credit Facilities expire on June 15, 2023. Interest on the Credit Facilities is established using LIBOR plus 1.13% - 1.75%, depending on the Company's leverage ratio. Under the Credit Facilities, the Company is required to maintain certain leverage and interest coverage ratios specified in the credit agreement as well as other customary non-financial affirmative and negative covenants. A portion of the net proceeds of $347.8 million was used to pay down the $253.7 million remaining outstanding balance on the 2012 credit agreement, as amended in fiscal 2014. The remainder of the proceeds are available to be used to support the launch of the NexSys PCS device and for general corporate purposes. At September 29, 2018, $345.6 million was outstanding under the Term Loan with an effective interest rate of 3.5% and no amount was outstanding on the Revolving Credit Facility. The Company also has $24.5 million of uncommitted operating lines of credit to fund its global operations under which there were no outstanding borrowings as of September 29, 2018.

The Company has required scheduled principal payments of $8.8 million during fiscal 2019, $17.5 million during each fiscal 2020, fiscal 2021 and fiscal 2022, $214.4 million during fiscal 2023 and $70.0 million thereafter.

The Company was in compliance with the leverage and interest coverage ratios specified in the Credit Facilities as well as all other bank covenants as of September 29, 2018.

12. DERIVATIVES AND FAIR VALUE MEASUREMENTS

The Company manufactures, markets and sells its products globally. During the three and six months ended September 29, 2018, 36.7% and 37.3%, respectively, of its sales were generated outside the U.S., generally in foreign currencies. The Company also incurs certain manufacturing, marketing and selling costs in international markets in local currency.

Accordingly, earnings and cash flows are exposed to market risk from changes in foreign currency exchange rates relative to the U.S. Dollar, the Company's reporting currency. The Company has a program in place that is designed to mitigate the exposure to changes in foreign currency exchange rates. That program includes the use of derivative financial instruments to minimize, for a period of time, the impact on its financial results from changes in foreign exchange rates. The Company utilizes foreign currency forward contracts to hedge the anticipated cash flows from transactions denominated in foreign currencies, primarily the Japanese Yen and the Euro, and to a lesser extent the Swiss Franc, Australian Dollar, Canadian Dollar and the Mexican Peso. This does not eliminate the impact of the volatility of foreign exchange rates. However, because the Company generally enters into forward contracts one year out, rates are fixed for a one-year period, thereby facilitating financial planning and resource allocation.

Designated Foreign Currency Hedge Contracts

All of the Company's designated foreign currency hedge contracts as of September 29, 2018 and March 31, 2018 were cash flow hedges under ASC 815, Derivatives and Hedging ("ASC 815"). The Company records the effective portion of any change in the fair value of designated foreign currency hedge contracts in other comprehensive income until the related third-party transaction occurs. Once the related third-party transaction occurs, the Company reclassifies the effective portion of any related gain or loss on the designated foreign currency hedge contracts to earnings. In the event the hedged forecasted transaction does not occur, or it becomes probable that it will not occur, the Company would reclassify the amount of any gain or loss on the

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