INTUITIVE SURGICAL INC
Form 10-Q
July 23, 2009
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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 June 30, 2009

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 000-30713

Intuitive Surgical, Inc.

(Exact name of Registrant as specified in its Charter)

Delaware	**77-0416458**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**

1266 Kifer Road

Sunnyvale, California 94086

(Address of Principal Executive Offices including Zip Code)

(408) 523-2100

(Registrant s Telephone Number, Including Area Code)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x 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 definition of large accelerated filer, accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	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 x

The Registrant had 37,934,659 shares of Common Stock, $0.001 par value per share, outstanding as of July 17, 2009.

INTUITIVE SURGICAL, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

INTUITIVE SURGICAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT PAR VALUE)

(UNAUDITED)

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 173,421	$ 194,623
Short-term investments	207,241	256,746
Accounts receivable, net	175,216	170,107
Inventory	59,247	63,460
Prepaids and other assets	13,634	9,496
Deferred tax assets	9,299	9,458
Total current assets	638,058	703,890
Property, plant and equipment, net	122,584	117,021
Long-term investments	521,399	450,504
Long-term deferred tax assets	44,124	35,899
Intangible assets, net	63,992	56,224
Goodwill	110,740	110,740
Other assets	385	346
Total assets	$ 1,501,282	$ 1,474,624
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 26,555	$ 20,501
Accrued compensation and employee benefits	29,315	36,930
Deferred revenue	88,215	77,981
Other accrued liabilities	34,915	29,104
Total current liabilities	179,000	164,516
Long-term liabilities	51,098	43,342
Total liabilities	230,098	207,858
Commitments and contingencies		
Stockholders equity:		
Preferred stock, 2,500 shares authorized, $0.001 par value, issuable in series; no shares issued and outstanding as of June 30, 2009 and December 31, 2008		
Common stock, 100,000 shares authorized, $0.001 par value, 37,931 and 39,183 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	38	39
Additional paid-in capital	900,712	871,846

Retained earnings	369,640	397,824
Accumulated other comprehensive income (loss)	794	(2,943)
Total stockholders equity	1,271,184	1,266,766
Total liabilities and stockholders equity	$ 1,501,282	$ 1,474,624

See accompanying Notes to Condensed Consolidated Financial Statements.

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INTUITIVE SURGICAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue:				
Products	$ 219,346	$ 189,780	$ 368,396	$ 350,731
Services	41,278	29,409	80,600	56,652
Total revenue	260,624	219,189	448,996	407,383
Cost of revenue:				
Products	55,542	50,036	100,808	94,888
Services	14,897	13,097	29,299	26,632
Total cost of revenue	70,439	63,133	130,107	121,520
Gross profit	190,185	156,056	318,889	285,863
Operating expenses:				
Selling, general, and administrative	67,276	57,504	129,642	106,138
Research and development	23,369	20,357	44,681	36,658
Total operating expenses	90,645	77,861	174,323	142,796
Income from operations	99,540	78,195	144,566	143,067
Interest and other income, net	5,171	5,707	10,187	14,248
Income before taxes	104,711	83,902	154,753	157,315
Income tax expense	42,323	32,720	64,223	61,352
Net income	$ 62,388	$ 51,182	$ 90,530	$ 95,963
Earnings per share:				
Basic	$ 1.65	$ 1.32	$ 2.36	$ 2.48
Diluted	$ 1.62	$ 1.28	$ 2.32	$ 2.40
Shares used in computing earnings per share:				
Basic	37,897	38,773	38,390	38,677
Diluted	38,557	39,980	38,946	39,914

See accompanying Notes to Condensed Consolidated Financial Statements.

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INTUITIVE SURGICAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(UNAUDITED)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Operating Activities:		
Net income	$ 90,530	$ 95,963
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,089	6,719
Amortization of intangible assets	7,857	4,075
Deferred income taxes	(8,417)	(7,600)
Income tax benefits from employee stock option plans and acquisition	715	38,018
Excess tax benefit from stock-based compensation	(970)	(35,580)
Share-based compensation expense	47,382	34,282
Changes in operating assets and liabilities:		
Accounts receivable	(5,108)	(31,713)
Inventory	4,212	(10,198)
Prepaids and other assets	(3,956)	4,416
Accounts payable	6,026	(9,828)
Accrued compensation and employee benefits	(7,622)	(3,301)
Deferred revenue	10,290	11,361
Accrued liabilities	23,085	7,571
Net cash provided by operating activities	173,113	104,185
Investing Activities:		
Purchase of investments	(303,224)	(417,496)
Proceeds from sales and maturities of investments	286,124	405,931
Purchase of property and equipment and acquisition of intellectual property	(40,334)	(52,035)
Net cash provided by (used in) investing activities	(57,434)	(63,600)
Financing Activities:		
Proceeds from issuance of common stock, net	12,054	23,318
Excess tax benefit from stock-based compensation	970	35,580
Repurchase and retirement of common stock	(150,000)	
Net cash provided by (used in) financing activities	(136,976)	58,898
Effect of exchange rate changes on cash and cash equivalents	95	715
Net increase (decrease) in cash and cash equivalents	(21,202)	100,198
Cash and cash equivalents, beginning of period	194,623	122,825
Cash and cash equivalents, end of period	$ 173,421	$ 223,023

See accompanying Notes to Condensed Consolidated Financial Statements.

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INTUITIVE SURGICAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In this report, Intuitive Surgical , Intuitive , and the Company refer to Intuitive Surgical, Inc.

NOTE 1. DESCRIPTION OF BUSINESS

Intuitive Surgical, Inc. designs, manufactures, and markets the *da Vinci* Surgical System, which is an advanced surgical system that the Company believes represents a new generation of surgery. The *da Vinci* Surgical System consists of a surgeon s console, a patient-side cart, a high performance vision system and proprietary wristed instruments. The *da Vinci* Surgical System seamlessly translates the surgeon s natural hand movements on instrument controls at the console into corresponding micro-movements of instruments positioned inside the patient through small puncture incisions, or ports. The Company markets its products through sales representatives in the United States, and through a combination of sales representatives and distributors in its international markets.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements (financial statements) of Intuitive Surgical, Inc., and its wholly-owned subsidiaries (collectively, the Company) have been prepared on a consistent basis with the December 31, 2008 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly state the information set forth herein. These financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC), and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008, which was filed on February 6, 2009. The results of operations for the first six months of fiscal 2009 are not indicative of the results to be expected for the entire fiscal year or any future periods.

Subsequent Events Evaluation

Management has reviewed and evaluated material subsequent events from the balance sheet date of June 30, 2009 through the financial statements issue date of July 23, 2009. All appropriate subsequent event disclosures, if any, have been made in notes to our unaudited Condensed Consolidated Financial Statements.

Foreign Currency and Other Hedging Instruments

The accounts of the Company s foreign subsidiaries are translated in accordance with SFAS No. 52, *Foreign Currency Translation* (SFAS 52). The Company has determined that the functional currency of its subsidiaries should be their local currency, with the exception of its subsidiaries in the Cayman Islands and Switzerland, whose functional currency is the U.S. dollar. For subsidiaries whose local currency is their functional currency, their assets and liabilities are translated into U.S. dollars at exchange rates at the balance sheet date and revenues and expenses are translated using average exchange rates in effect during the quarter. Gains and losses from foreign currency translation are included in accumulated other comprehensive income (loss) within stockholders equity in the accompanying unaudited condensed consolidated balance sheets.

For all non functional currency account balances, the re-measurement of such balances to the functional currency will result in either a foreign exchange gain or loss which is recorded to interest and other income, net in the same accounting period that the re-measurement occurred.

In January 2009, the Company began a hedging program to address the risk associated with non-functional currency (primarily Euro) financial statement exposures. The Company accounts for these instruments in accordance with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended*, (SFAS 133) which requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its fair value as of the reporting date. Derivative valuations are determined using SFAS No. 157, *Fair Value Measurements* (SFAS 157) Level 2 inputs (as defined on Note 3), including closing currency prices and observable inputs other than quoted prices, including interest rates, forward points and credit risk.

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The Company sells products to certain European customers in foreign currencies. Fluctuations in exchange rates can change the Company s U.S. dollar equivalent revenue and hence the Company s U.S. dollar earnings. The Company hedges a portion of forecasted foreign currency denominated sales (primarily Euro-denominated) utilizing foreign exchange forward contracts. These transactions are designated as cash flow hedges and are accounted for under the hedge accounting provisions of SFAS No. 133. The effective portion of the hedge gain or loss is reported as a component of accumulated other comprehensive income (loss) and subsequently reclassified into net revenues when the hedged exposure affects earnings. Any ineffective portions of related gains or losses are recorded in the statements of income immediately. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, the Company will reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to net revenues on its consolidated statement of income.

The Company also hedges the net recognized non-functional currency balance sheet exposures with foreign exchange forward contracts to reduce the risk that its earnings and cash flows will be adversely affected by changes in exchange rates. These derivative instruments are carried at fair value with changes in the fair value recorded to interest and other income, net on the Company s consolidated statement of income and are intended to offset gains and losses on the assets and liabilities being hedged.

The bank counterparties to the foreign exchange forward contracts expose the Company to credit-related losses in the event of their nonperformance. However, to mitigate that risk, the Company only contracts with counterparties that meet certain minimum requirements under its counterparty risk assessment process. The Company monitors ratings, and potential downgrades on at least a quarterly basis. Based on its on-going assessment of counterparty risk, the Company will adjust its exposure to various counterparties.

Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended June 30, 2009, as compared to the recent accounting pronouncements described in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008, that are of significance, or potential significance to the Company.

Adopted Accounting Pronouncements

Effective April 1, 2009, the Company adopted three Financial Accounting Standard Board (FASB) Staff Positions (FSP) that were intended to provide additional application guidance and enhanced disclosures regarding fair value measurements and impairments of securities. FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidelines for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements.* FSP No. 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, changes existing accounting requirements for other-than-temporary-impairment (OTTI) for debt securities by replacing the current requirement that a holder have the positive intent and ability to hold an impaired security to recovery in order to conclude an impairment was temporary with a requirement that an entity conclude it does not intend to sell an impaired security and it will not be required to sell the security before the recovery of its amortized cost basis. FSP No. 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, increases the frequency of fair value disclosures. These FSPs are effective for fiscal years and interim periods ended after June 15, 2009. The adoption of these FSPs did not have any impact on the Company s consolidated financial statements.

Effective April 1, 2009, the Company adopted the FASB issued SFAS No. 165, Subsequent Events (SFAS 165). The standard modifies the names of the two types of subsequent events either as recognized subsequent events (previously referred to in practice as Type I subsequent events) or non-recognized subsequent events (previously referred to in practice as Type II subsequent events). In addition, the standard modifies the definition of subsequent events to refer to events or transactions that occur after the balance sheet date, but before the financial statements are issued (for public entities) or available to be issued (for nonpublic entities). It also requires the disclosure of the date through which subsequent events have been evaluated. The standard did not result in significant changes in the practice of subsequent event disclosures or the related accounting thereof, and therefore the adoption did not have any impact on the Company s consolidated financial statements.

Effective January 1, 2009, the Company adopted the Emerging Issues Task Force issued EITF No. 08-7, *Accounting for Defensive Intangible Assets* (EITF 08-7) that clarifies accounting for defensive intangible assets subsequent to initial measurement. EITF 08-7 applies to acquired intangible assets which an entity has no intention of actively using, or intends to discontinue use of, the intangible asset but holds it to prevent others from obtaining access to it (i.e., a defensive intangible asset). Under EITF 08-7, the Task Force reached a consensus that an acquired defensive asset should be accounted for as a separate unit of accounting (i.e., an asset separate from other assets of the acquirer); and the useful life assigned to an acquired defensive asset should be based on the period during which the asset would diminish in value. The adoption did not have any impact on the Company s consolidated financial statements.