OWENS & MINOR INC/VA/
Form 10-Q
November 05, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
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 1-9810

Owens & Minor, Inc.
(Exact name of Registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-1701843 (I.R.S. Employer Identification No.)
9120 Lockwood Boulevard, Mechanicsville, Virginia (Address of principal executive offices)	23116 (Zip Code)
Post Office Box 27626, Richmond, Virginia (Mailing address of principal executive offices)	23261-7626 (Zip Code)

Registrant’s telephone number, including area code (804) 723-7000

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 ¨

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 ¨

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

Large accelerated filer	x	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 ¨ No x
The number of shares of Owens & Minor, Inc.'s common stock outstanding as of October 29, 2018, was 62,268,831 shares.

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Owens & Minor, Inc. and Subsidiaries
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Part I. Financial Information

Item 1. Financial Statements
Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Income (Loss)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2018	2017	2018	2017
Net revenue	$2,464,877	$2,333,961	$7,295,727	$6,928,441
Cost of goods sold	2,112,303	2,032,019	6,293,474	6,071,787
Gross margin	352,574	301,942	1,002,253	856,654
Distribution, selling, and administrative expenses	325,012	261,045	918,147	735,353
Goodwill and intangible asset impairment charges	—	—	165,447	—
Acquisition-related and exit and realignment charges	7,727	9,299	47,416	21,134
Other operating (income) expense, net	(1,522)	1,927	(2,281)	2,143
Operating income (loss)	21,357	29,671	(126,476)	98,024
Interest expense, net	23,826	8,737	52,651	22,218
Income (loss) before income taxes	(2,469)	20,934	(179,127)	75,806
Income tax provision (benefit)	(1,904)	10,063	(3,936)	26,010
Net income (loss)	$(565)	$10,871	$(175,191)	$49,796
Net income (loss) per common share: basic and diluted	$(0.01)	$0.18	$(2.92)	$0.82
Cash dividends per common share	$0.26	$0.2575	$0.78	$0.7725

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2018	2017	2018	2017
Net income (loss)	$(565)	$10,871	$(175,191)	$49,796
Other comprehensive income (loss), net of tax:				
Currency translation adjustments (net of income tax of $0 in 2018 and 2017)	350	12,254	(11,407)	40,151
Change in unrecognized net periodic pension costs (net of income tax of $161 and $449 in 2018 and $220 and $665 in 2017)	362	236	1,116	702
Net unrealized gain (loss) on derivative instruments and other (net of income tax of $103 and $30 in 2018 and $0 in 2017)	2,320	94	2,204	288
Total other comprehensive income (loss), net of tax	3,032	12,584	(8,087)	41,141
Comprehensive income (loss)	$2,467	$23,455	$(183,278)	$90,937

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(in thousands, except per share data)	September 30, 2018	December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$124,890	$104,522
Accounts receivable, net of allowances of $19,558 and $16,280	870,187	758,936
Merchandise inventories	1,203,838	990,193
Other current assets	293,993	328,254
Total current assets	2,492,908	2,181,905
Property and equipment, net of accumulated depreciation of $259,730 and $239,581	343,710	206,490
Goodwill, net	761,173	713,811
Intangible assets, net	332,172	184,468
Other assets, net	102,318	89,619
Total assets	$4,032,281	$3,376,293
Liabilities and equity		
Current liabilities		
Accounts payable	$1,107,541	$947,572
Accrued payroll and related liabilities	47,404	30,416
Other current liabilities	301,800	331,745
Total current liabilities	1,456,745	1,309,733
Long-term debt, excluding current portion	1,640,455	900,744
Deferred income taxes	66,445	74,247
Other liabilities	76,223	76,090
Total liabilities	3,239,868	2,360,814
Commitments and contingencies		
Equity		
Common stock, par value $2 per share; authorized - 200,000 shares; issued and outstanding - 62,269 shares and 61,476 shares	124,538	122,952
Paid-in capital	233,920	226,937
Retained earnings	467,126	690,674
Accumulated other comprehensive loss	(33,171)	(25,084)
Total equity	792,413	1,015,479
Total liabilities and equity	$4,032,281	$3,376,293

See accompanying notes to consolidated financial statements.

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Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine Months Ended September 30, 2018	2017
Operating activities:		
Net income (loss)	$(175,191)	$49,796
Adjustments to reconcile net income (loss) to cash provided by (used for) operating activities:		
Depreciation and amortization	73,596	41,060
Share-based compensation expense	10,499	8,592
Goodwill and intangible asset impairment charges	165,447	—
Provision for losses on accounts receivable	5,757	1,158
Deferred income tax (benefit) expense	(6,754)	(4,585)
Changes in operating assets and liabilities:		
Accounts receivable	(51,603)	(79,114)
Merchandise inventories	21,244	(56,134)
Accounts payable	88,198	79,787
Net change in other assets and liabilities	(11,522)	(40,634)
Other, net	2,838	5,719
Cash provided by operating activities	122,509	5,645
Investing activities:		
Acquisitions, net of cash acquired	(751,834)	(366,569)
Additions to property and equipment	(32,489)	(24,963)
Additions to computer software and intangible assets	(14,816)	(12,826)
Proceeds from sale of property and equipment	258	780
Cash used for investing activities	(798,881)	(403,578)
Financing activities:		
Proceeds from issuance of debt	695,750	250,000
Financing costs paid	(28,512)	(1,798)
Repayments of debt	(9,375)	—
Proceeds from revolving credit facility	74,762	117,200
Cash dividends paid	(32,151)	(47,316)
Repurchases of common stock	—	(5,000)
Other, net	(5,308)	(7,363)
Cash provided by financing activities	695,166	305,723
Effect of exchange rate changes on cash and cash equivalents	1,574	5,137
Net increase (decrease) in cash and cash equivalents	20,368	(87,073)
Cash and cash equivalents at beginning of period	104,522	185,488
Cash and cash equivalents at end of period	$124,890	$98,415
Supplemental disclosure of cash flow information:		
Income taxes paid, net	$26,570	$26,917
Interest paid	$45,313	$19,951

See accompanying notes to consolidated financial statements.

Owens & Minor, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity
(unaudited)

(in thousands, except per share data)	Common Shares Outstanding	Common Stock ($ 2 par value)	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance December 31, 2016	61,031	$122,062	$219,955	$685,504	$ (67,483)	$960,038
Net income (loss)				49,796		49,796
Other comprehensive income (loss)					41,141	41,141
Dividends declared ($0.7725 per share)				(47,169)		(47,169)
Shares repurchased and retired	(155)	(310)		(4,687)		(4,997)
Share-based compensation expense, exercises and other	373	747	4,228			4,975
Balance September 30, 2017	61,249	$122,499	$224,183	$683,444	$ (26,342)	$1,003,784
Balance December 31, 2017	61,476	$122,952	$226,937	$690,674	$ (25,084)	$1,015,479
Net income (loss)				(175,191)		(175,191)
Other comprehensive income (loss)					(8,087)	(8,087)
Dividends declared ($0.78 per share)				(48,357)		(48,357)
Share-based compensation expense, exercises and other	793	1,586	6,983			8,569
Balance September 30, 2018	62,269	$124,538	$233,920	$467,126	$ (33,171)	$792,413

See accompanying notes to consolidated financial statements.
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Owens & Minor, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)
(in thousands, unless otherwise indicated)

Note 1—Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Owens & Minor, Inc. and the subsidiaries it controls (we, us, or our) and contain all adjustments (which are comprised only of normal recurring accruals and use of estimates) necessary to conform with U.S. generally accepted accounting principles (GAAP). All significant intercompany accounts and transactions have been eliminated. The results of operations for interim periods are not necessarily indicative of the results expected for the full year.

During the first quarter, we made certain changes to the leadership team, organizational structure, budgeting and financial reporting processes which resulted in changes to our segment reporting. These changes align our operations into two distinct business units: Global Solutions and Global Products. Global Solutions (previously Domestic and International) is our U.S. and European distribution, logistics and value-added services business. Global Products (previously Proprietary Products) provides product-related solutions, including surgical and procedural kitting and sourcing. The Halyard Surgical & Infection Prevention business (Halyard S&IP or Halyard), acquired April 30, 2018, is included in the Global Products segment. Beginning with the quarter ended March 31, 2018, we reported financial results using this two segment structure and have recast prior year segment results on the same basis.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make assumptions and estimates that affect reported amounts and related disclosures. Actual results may differ from these estimates.

Revenue Recognition

On January 1, 2018, we adopted ASC 606 Revenue from Contracts with Customers, which establishes principles for recognizing revenue and reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We applied the guidance using the modified retrospective transition method. The adoption of this guidance had no impact on the amount and timing of revenue recognized, therefore, no adjustments were recorded to our consolidated financial statements upon adoption.

Our revenue is primarily generated from sales contracts with customers. Under most of our distribution and product sales arrangements, our performance obligations are limited to delivery of products to a customer upon receipt of a purchase order. For these arrangements, we recognize revenue at the point in time when shipment is completed, as control passes to the customer upon product receipt.

Revenue for activity-based fees and other services is recognized over time as activities are performed. Depending on the specific contractual provisions and nature of the performance obligation, revenue from services may be recognized on a straight-line basis over the term of the service, on a proportional performance model, based on level of effort, or when final deliverables have been provided.

Our contracts sometimes allow for forms of variable consideration including rebates, discounts and performance guarantees. In these cases, we estimate the amount of consideration to which we will be entitled in exchange for transferring the product or service to the customer. Rebates and customer discounts are estimated based on contractual terms or historical experience and we maintain a liability for rebates or discounts that have been earned but are unpaid. The amount accrued for rebates and discounts due to customers was $41.7 million at September 30, 2018 and $13.0 million at December 31, 2017.

Additionally, we generate fees from arrangements that include performance targets related to cost-saving initiatives for customers that result from our supply-chain management services. Achievement against performance targets, measured in accordance with contractual terms, may result in additional fees paid to us or, if performance targets are not achieved, we may be obligated to refund or reduce a portion of our fees or to provide credits toward future purchases by the customer. For these arrangements, contingent revenue is deferred and recognized as the performance target is achieved and the applicable contingency is released. When we determine that a loss is probable under a contract, the estimated loss is accrued. The amount deferred under these arrangements is not material.

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For our direct to patient sales, revenues are recorded based upon the estimated amounts due from patients and third-party payors. Third-party payors include federal and state agencies (under Medicare and Medicaid programs), managed care health plans and commercial insurance companies. Estimates of contractual allowances are based upon historical collection rates for the related payor agreements. The estimated reimbursement amounts are made on a payor-specific basis and are recorded based on the best information available regarding management's interpretation of the applicable laws, regulations and reimbursement terms.

In most cases, we record revenue gross, as we are the primary obligor in the arrangement and we obtain control of the products before they are transferred to the customer. When we act as an agent in a sales arrangement and do not bear a significant portion of inventory risks, primarily for our third-party logistics business, we record revenue net of product cost. Sales taxes collected from customers and remitted to governmental authorities are excluded from revenues.

See Note 14 for disaggregation of revenue by segment and geography as we believe that best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors.

Note 2—Fair Value

The carrying amounts of cash and cash equivalents, accounts receivable, financing receivables, accounts payable and financing payables included in the consolidated balance sheets approximate fair value due to the short-term nature of these instruments. The fair value of long-term debt is estimated based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market (Level 1) or, if quoted market prices or dealer quotes are not available, on the borrowing rates currently available for loans with similar terms, credit ratings and average remaining maturities (Level 2). We determine the fair value of our derivatives based on estimated amounts that would be received or paid to terminate the contracts at the reporting date based on current market prices for applicable currencies. See Notes 6 and 9 for the fair value of derivatives and long-term debt.

Note 3—Acquisitions

Avanos Medical Inc.'s (previously Halyard Health, Inc.) S&IP Business

On April 30, 2018 (the Closing Date), we completed the previously announced acquisition of substantially all of Avanos Medical, Inc.'s (Avanos, previously Halyard Health, Inc.) Surgical and Infection Prevention business, the name "Halyard Health" (and all variations of that name and related intellectual property rights) and its IT system in exchange for $758 million, net of cash acquired. The Halyard S&IP business is a leading global provider of medical supplies and solutions for the prevention of healthcare associated infections across acute care and non-acute care markets. This business is reported as part of the Global Products segment.

The following table presents the preliminary estimated fair value of the assets acquired and liabilities assumed recognized as of the acquisition date. The fair value of intangibles from this acquisition was primarily determined by applying the income approach, using several significant unobservable inputs for projected cash flows and a discount rate. These inputs are considered Level 3 inputs. The allocation of purchase price to assets and liabilities acquired is not yet complete, as valuations of tangible and intangible assets and liabilities are still in process.

	Preliminary Fair Value Originally Estimated as of Acquisition Date (1)	Differences Between Prior and the Current Periods Preliminary Fair Value Estimate	Fair Value Estimated as of Acquisition Date
Assets acquired:			
Current assets	$ 307,427	$ —	$ 307,427
Goodwill	183,711	19,055	202,766
Intangible assets	191,000	—	191,000
Other noncurrent assets	152,555	1,019	153,574
Total assets	834,693	20,074	854,767
Liabilities assumed:			

Current liabilities	83,822	1,673	85,495
Noncurrent liabilities	11,223	—	11,223
Total liabilities	95,045	1,673	96,718
Fair value of net assets acquired, net of cash	$ 739,648	$ 18,401	$ 758,049

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(1) As previously reported in our second quarter 2018 Form 10-Q.

The change in fair value of net assets acquired, net of cash, of $18.4 million was the result of the final purchase price settlement with the seller of the Halyard S&IP business.

We are amortizing the preliminary fair value of acquired intangible assets, primarily customer relationships, a trade name and other intellectual property, over their estimated weighted average useful lives of eight to 12 years.

Goodwill of $203 million, which we assigned to our Global Products segment, consists largely of expected opportunities to expand into new markets and further develop a presence in the medical products segment. None of the goodwill recognized is expected to be deductible for income tax purposes.

The following table provides pro forma results of net revenue for the three and nine months ended September 30, 2018 and 2017 as if Halyard S&IP was acquired on January 1, 2017. The pro forma results of net income (loss) and net income (loss) per common share have not been represented because the effects were not material to our historic consolidated financial statements. Accordingly, the pro forma results below are not necessarily indicative of the results that would have been if the acquisition had occurred on the dates indicated, nor are the pro forma results indicative of results which may occur in the future.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net revenue	$2,464,877	$2,543,961	$7,575,727	$7,558,441

Byram Healthcare

On August 1, 2017, we completed the acquisition of Byram Healthcare, a leading domestic distributor of reimbursable medical supplies sold directly to patients and home health agencies. The consideration was $360 million, net of cash acquired. The purchase price was allocated to the underlying assets acquired and liabilities assumed based upon our estimate of their fair values at the date of acquisition. The purchase price exceeded the estimated fair value of the net tangible and identifiable intangible assets by $284 million which was allocated to goodwill.

The following table presents the fair value of the assets acquired and liabilities assumed recognized as of the acquisition date. The fair value of intangibles from this acquisition was primarily determined by applying the income approach, using several significant unobservable inputs for projected cash flows and a discount rate. These inputs are considered Level 3 inputs.

	Preliminary Fair Value Originally Estimated as of Acquisition Date (2)	Differences Between Prior and the Current Periods Preliminary Fair Value Estimate	Fair Value as of Acquisition Date
Assets acquired:			
Current assets	$ 61,986	$ —	$ 61,986
Goodwill	288,691	(4,933)	283,758
Intangible assets	115,000	—	115,000
Other noncurrent assets	5,069	(1,282)	3,787
Total assets	470,746	(6,215)	464,531
Liabilities assumed:			
Current liabilities	72,962	—	72,962
Noncurrent liabilities	31,215	—	31,215
Total liabilities	104,177	—	104,177
Fair value of net assets acquired, net of cash	$ 366,569	$ (6,215)	$ 360,354

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[2] As previously reported in our 2017 Form 10-K.

We are amortizing the fair value of acquired intangible assets, primarily chronic customer relationships and a trade name, over their weighted average useful lives of three to 10 years.

Goodwill of $284 million, which we assigned to our Global Solutions segment, consists largely of expected opportunities to grow in the non-acute market with direct to patient and home health agency distribution capabilities. None of the goodwill recognized is expected to be deductible for income tax purposes.

Pro forma results of operations for Byram have not been presented because the effects on revenue and net income were not material to our historic consolidated financial statements.

The change in fair value of net assets acquired, net of cash, of $6.2 million was the result of the final purchase price settlement with the seller of Byram.

Acquisition-related expenses in the current quarter and year-to-date consisted primarily of transition and transaction costs for the Halyard S&IP transaction. Expenses in the prior year periods were primarily related to Byram. We recognized pre-tax acquisition-related expenses of $5.7 million and $41.0 million in the three and nine month periods ended September 30, 2018 and $4.3 million and $6.3 million related to these activities in the same periods of 2017.

Note 4—Financing Receivables and Payables

At September 30, 2018 and December 31, 2017, we had financing receivables of $146.8 million and $192.1 million and related payables of $88.1 million and $124.9 million outstanding under our order-to-cash program and product financing arrangements, which were included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

Note 5—Goodwill and Intangible Assets

We test goodwill for impairment annually (as of October 1) or more frequently whenever events or circumstances more likely than not indicate that the fair value of the reporting unit may be below its carrying amount. As a result of lower than projected financial results of certain reporting units due to customer losses and operational inefficiencies, which have caused us to revise our expectations with regard to future performance, and a decline in market capitalization of the Company, we determined that there were indicators present that would require an interim impairment analysis. During the quarter ended June 30, 2018, we performed an interim goodwill impairment test and concluded that the fair values for certain reporting units comprising our kitting business within our Global Products segment were below their carrying amount.

We determined the estimated fair value of our reporting units by using an income (discounted cash flow analysis) approach. The income approach is dependent upon several assumptions regarding future periods, including assumptions with respect to future sales growth and a terminal growth rate. In addition, a weighted average cost of capital (“WACC”) was used to discount future estimated cash flows to their present values. The WACC was based on externally observable data considering market participants’ cost of equity and debt, optimal capital structure and risk factors specific to our company.

In conjunction with our interim impairment testing performed during the quarter ended June 30, 2018, we adopted ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. See Note 16 for further information.

The amount by which the carrying values of the impaired reporting units' goodwill exceeded their fair values was $149.0 million, which was recognized as an impairment loss for the quarter ended June 30, 2018 in the accompanying consolidated statements of income (loss) as “Goodwill and intangible asset impairment charges.”

In connection with our new segment structure, which began in the first quarter of 2018, goodwill is now reported as part of Global Solutions or Global Products. There was no change to our underlying reporting units as part of that segment change and therefore no reallocation of goodwill. The following table summarizes the goodwill balances by segment and the changes in the carrying amount of goodwill through September 30, 2018:

	Global Solutions	Global Products	Consolidated
Carrying amount of goodwill, December 31, 2017	$495,860	$217,951	$ 713,811
Currency translation adjustments	(1,013)	(490)	(1,503)
Acquisitions (see Note 3)	(4,933)	202,766	197,833
Carrying amount of goodwill, September 30, 2018	489,914	420,227	910,141
Accumulated goodwill impairment, December 31, 2017	—	—	—
Goodwill impairment charge	—	(148,968)	(148,968)
Accumulated goodwill impairment, September 30, 2018	—	(148,968)	(148,968)
Net carrying amount of goodwill, September 30, 2018	$489,914	$271,259	$ 761,173

Intangible assets at September 30, 2018, and December 31, 2017, were as follows:

	September 30, 2018			December 31, 2017		
	Customer Relationships	Tradenames	Other Intangibles	Customer Relationships	Tradenames	Other Intangibles
Gross intangible assets	$267,850	$ 97,000	$ 44,261	$199,265	$ 31,000	$ 12,537
Accumulated amortization	(66,233)	(6,308)	(4,398)	(54,757)	(1,769)	(1,808)
Net intangible assets	$201,617	$ 90,692	$ 39,863	$144,508	$ 29,231	$ 10,729

During the quarter ended June 30, 2018, we noted impairment indicators related to our intangible assets. Consistent with the impairment indicators that were considered in performing our interim goodwill impairment assessment, lower than projected financial results of certain reporting units due to customer losses and operational inefficiencies have caused us to revise our expectations with regard to future performance. We performed an impairment test based on the projected undiscounted future cash flows, resulting in the recording of an impairment charge of $16.5 million related to a write-off of customer relationships in our kitting business within our Global Products segment. We recorded this amount in “Goodwill and intangible asset impairment charges” in our accompanying consolidated statements of income (loss).

At September 30, 2018, $112.1 million in net intangible assets were held in the Global Solutions segment and $220.1 million were held in the Global Products segment. Amortization expense for intangible assets was $10.4 million and $5.1 million for the three months ended September 30, 2018 and 2017 and $26.1 million and $9.7 million for the nine months ended September 30, 2018 and 2017.

Based on the current carrying value of intangible assets subject to amortization, estimated amortization expense is $10.4 million for the remainder of 2018, $41.6 million for 2019, $40.6 million for 2020, $38.9 million for 2021, $38.0 million for 2022 and $37.8 million for 2023.

Note 6—Derivatives

We are directly and indirectly affected by changes in foreign currency, which may adversely impact our financial performance and are referred to as “market risks.” When deemed appropriate, we use derivatives as a risk management tool to mitigate the potential impact of certain market risks. We do not enter into derivative financial instruments for trading purposes.

We use a layered hedging program to hedge select anticipated foreign currency cash flows to reduce volatility in cash flows. We account for the designated foreign exchange forward contracts as cash flow hedges. These foreign exchange forward contracts generally have maturities up to 12 months and the counterparties to the transactions are typically large international financial institutions.

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We pay interest under our Credit Agreement which fluctuates based on changes in our benchmark interest rates. In order to mitigate the risk, we entered into interest rate swaps during the third quarter whereby we agree to exchange with the counterparty, at specified intervals, the difference between fixed and variable amounts calculated by reference to the notional amount. The interest rate swaps were designated as cash flow hedges. Cash flows related to the interest rate swap agreements is included in interest expense.

We determine the fair value of our foreign currency derivatives and our interest rate swaps based on observable market-based inputs or unobservable inputs that are corroborated by market data. We do not view the fair value of our derivatives in isolation, but rather in relation to the fair values or cash flows of the underlying exposure. Our derivatives are over-the-counter instruments with liquid markets. All derivatives are carried at fair value in our consolidated balance sheets in other assets and other liabilities line items. We consider the risk of counterparty default to be minimal. We present cash flows from our hedging instruments in the same cash flow statement category as the hedged items.

The following table summarizes our outstanding cash flow hedges as of September 30, 2018:

	Notional Amount	Fair Value	Level in Fair Value Hierarchy	Maturity Date
Interest rate swaps	$450,000	$1,794	Level 2	May 2022 & May 2025
Foreign currency contracts	$20,595	$166	Level 2	December 2018 - September 2019

The following table summarizes the gain (loss) included in accumulated other comprehensive loss for our hedges as of September 30, 2018:

Interest rate swaps	$1,794
Foreign currency contracts	$166

For the three and nine months ended September 30, 2018, we reclassified $0.4 million associated with our interest rate swaps and $0.1 million and $0.4 million, respectively, associated with our foreign currency contracts out of accumulated other comprehensive income (loss). The amount of ineffectiveness associated with these contracts was immaterial for the periods presented.

We enter into foreign currency contracts to manage our foreign exchange exposure related to certain balance sheet items that do not meet the requirements for hedge accounting. With the acquisition of the Halyard business, we also assumed foreign currency contracts that mature through April 2019 and do not meet the requirements for hedge accounting treatment. These derivative instruments are adjusted to fair value at the end of each period through earnings. The gain or loss recorded on these instruments is substantially offset by the remeasurement adjustment on the foreign currency denominated asset or liability. We record the change in fair value of derivative instruments and the remeasurement adjustment on the foreign currency denominated asset or liability in acquisition-related and exit and realignment charges for contracts assumed with the Halyard acquisition and in other operating (income) expense, net for all other foreign exchange contracts.

The following table summarizes our outstanding economic (non-designated) hedges as of September 30, 2018:

	Notional Amount	Fair Value	Level in Fair Value Hierarchy	Maturity Date
Foreign currency contracts	$34,817	$ 317	Level 2	October 2018 - April 2019

For the three and nine months ended September 30, 2018, we recognized income of $0.5 million and losses of $2.3 million associated with our economic (non-designated) foreign currency contacts.

We were not a party to any derivatives for the year ended December 31, 2017.

Note 7—Exit and Realignment Charges

We periodically incur exit and realignment and other charges associated with optimizing our operations, which includes the consolidation of certain distribution and logistics centers, administrative offices and warehouses in the United States and Europe. These charges also include costs associated with our strategic organizational realignment which include management changes, certain professional fees and costs to streamline administrative functions and processes.

Exit and realignment charges by segment for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Global Solutions segment	$2,085	$4,454	$6,523	$13,827
Global Products segment	(80)	592	(108)	1,015
Total exit and realignment charges	$2,005	$5,046	$6,415	$14,842

The following table summarizes the activity related to exit and realignment cost accruals through September 30, 2018 and 2017:

	Lease Obligations	Severance and Other	Total
Accrued exit and realignment costs, December 31, 2017	$ —	$ 11,972	$11,972
Provision for exit and realignment activities	—	2,295	2,295
Change in estimate	—	(23)	(23)
Cash payments	—	(6,479)	(6,479)
Accrued exit and realignment costs, March 31, 2018	—	7,765	7,765
Provision for exit and realignment activities	—	(415)	(415)
Change in estimate	—	—	—
Cash payments	—	(4,207)	(4,207)
Accrued exit and realignment costs, June 30, 2018	—	3,143	3,143
Provision for exit and realignment activities	—	640	640
Change in estimate	—	(85)	(85)
Cash payments	—	(2,487)	(2,487)
Accrued exit and realignment costs, September 30, 2018	$ —	$ 1,211	$1,211
Accrued exit and realignment costs, December 31, 2016	$ —	$ 2,238	$2,238
Provision for exit and realignment activities	—	3,211	3,211
Change in estimate	—	(304)	(304)
Cash payments	—	(3,034)	(3,034)
Accrued exit and realignment costs, March 31, 2017	—	2,111	2,111
Provision for exit and realignment activities	—	1,382	1,382
Change in estimate	—	(18)	(18)
Cash payments	—	(667)	(667)
Accrued exit and realignment costs, June 30, 2017	—	2,808	2,808
Provision for exit and realignment activities	—	3,156	3,156
Cash payments	—	(423)	(423)
Accrued exit and realignment costs, September 30, 2017	$ —	$ 5,541	$5,541

In addition to the exit and realignment accruals in the preceding table, we also incurred $1.4 million of costs that were expensed as incurred for the quarter ended September 30, 2018, including $0.6 million in information system restructuring costs and $0.8 million in other costs. For the first nine months of 2018, we incurred $4.0 million in costs that were expensed as incurred, including $1.9 million in information system restructuring costs and $2.1 million in other costs.

We incurred $1.9 million of costs that were expensed as incurred for the three months ended September 30, 2017, including $1.7 million in information system restructuring costs and $0.2 million in other costs. In the first nine months of 2017, we incurred $7.4 million of costs that were expensed as incurred, including $4.5 million in asset write-downs, $1.9 million in information system restructuring costs and $1.0 million in other costs.

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Note 8—Retirement Plans

We have a noncontributory, unfunded retirement plan for certain officers and retirees in the United States. Certain of our foreign subsidiaries also have defined benefit pension plans covering substantially all of their respective employees.

The components of net periodic benefit cost, which are included in distribution, selling and administrative expenses, for the three and nine months ended September 30, 2018 and 2017, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Service cost	$(28)	$26	$10	$53
Interest cost	418	474	1,256	1,422
Recognized net actuarial loss	522	456	1,566	1,367
Net periodic benefit cost	$912	$956	$2,832	$2,842

Certain of our foreign subsidiaries have health and welfare plans covering substantially all of their respective employees. Our expense for these plans totaled $0.5 million and $0.5 million for the three months ended September 30, 2018 and 2017, respectively and $1.6 million and $1.3 million for the nine months ended September 30, 2018 and 2017, respectively.

Note 9—Debt

We have $275 million of 3.875% senior notes due 2021 (the “2021 Notes”) and $275 million of 4.375% senior notes due 2024 (the “2024 Notes”), with interest payable semi-annually. The 2021 Notes were sold at 99.5% of the principal amount with an effective yield of 3.951%. The 2024 Notes were sold at 99.6% of the principal with an effective yield of 4.422% . We have the option to redeem the 2021 Notes and 2024 Notes in part or in whole prior to maturity at a redemption price equal to the greater of 100% of the principal amount or the present value of the remaining scheduled payments discounted at the Treasury Rate plus 30 basis points. As of September 30, 2018 and December 31, 2017, the estimated fair value of the 2021 Notes was $258.0 million and $278.1 million and the estimated fair value of the 2024 Notes was $235.5 million and $277.9 million, respectively.

We have a Credit Agreement with a borrowing capacity of $600 million and a $250 million Term A-1 loan. In connection with the Halyard S&IP acquisition, we amended our Credit Agreement to include, among others things, an additional $195.8 million Term A-2 loan and $500 million Term B loan. The revolving credit facility and Term A loans mature in July 2022 and the Term B loan matures in October 2025.

In connection with amending our Credit Agreement, we entered into a Security and Pledge Agreement (the “Security Agreement”) pursuant to which we granted collateral on behalf of the holders of the 2021 Notes and the 2024 Notes and parties secured on the Credit Agreement (“the Secured Parties") including first priority liens and security interests in (a) all present and future shares of capital stock owned by the Credit Parties (as defined) in the Credit Parties’ present and future subsidiaries (limited, in the case of controlled foreign corporations, to a pledge of 65% of the voting capital stock of each first-tier foreign subsidiary of each Credit Party) and (b) all present and future personal property and assets of the Credit Parties, subject to certain exceptions. Our Credit Agreement has a “springing maturity date” with respect to the revolving loans and the term A loans and the term B loans, if as of the date that is 91 days prior to the maturity date of the Company’s 2021 Notes or the 2024 Notes, respectively, all outstanding amounts owing under the 2021 Notes or the 2024 Notes, respectively, have not been paid in full then the Termination Date (as defined in the Credit Agreement) of the revolving loans, term A loans and term B loans shall be the date that is 91 days prior to the maturity date of the 2021 Notes.

We make principal payments under the term loans on a quarterly basis with the remaining outstanding principal due upon maturity. Under the Credit Agreement, we have the ability to request two one-year extensions and to request an increase in aggregate commitments by up to $200 million. The interest rate on our revolving credit facility and Term A loans, which is subject to adjustment quarterly, is based on the Eurocurrency Rate, the Federal Funds Rate or the

Prime Rate, plus an adjustment based on the better of our credit ratings or debt to EBITDA ratio as defined by the Credit Agreement. Our Term B loan pays interest based on the Eurocurrency Rate, the Federal Funds Rate or the Prime Rate, plus interest rate margin of 3.50% per annum with respect to Base Rate Loans (as defined in the Credit Agreement), and 4.50% per annum with respect to Eurocurrency Rate Loans (as defined in the Credit Agreement). We are charged a commitment fee of between 12.5 and 25.0 basis points on the unused portion of the facility. The terms of the Credit Agreement limit the amount of indebtedness that we may incur and require us to maintain ratios for leverage and interest coverage, including on a pro forma basis in the event of an acquisition. Based on our Credit Spread, the interest rate under the credit facility at September 30, 2018 is Eurocurrency Rate plus 2.00%.

At September 30, 2018, we had borrowings of $179.4 million under the revolver and letters of credit of $13.9 million outstanding under the Credit Agreement, leaving $406.7 million available for borrowing. We also had letters of credit outstanding for $6.4 million as of September 30, 2018 and $1.3 million as of December 31, 2017, which supports certain facilities leased in the United States and Europe.

Scheduled future principal payments of debt are $6.9 million in 2018, $27.5 million in 2019, $30.3 million in 2020, $316.6 million in 2021, $527.7 million in 2022, and $753.8 million thereafter.

The Credit Agreement and senior notes contain cross-default provisions which could result in the acceleration of payments due in the event of default of either agreement. We believe we were in compliance with our debt covenants at September 30, 2018.

Note 10—Income Taxes

The effective tax rate was 77.1% and 2.2% for the three and nine months ended September 30, 2018, compared to 48.1% and 34.3% in the same periods of 2017. The change in the effective tax rate compared to 2017 resulted primarily from losses in jurisdictions with full valuation allowances, and discrete items related to tax reform and the release of certain reserves for uncertain tax positions. On a year-to-date basis, the rate was also affected by the goodwill and intangible asset impairment charges in the second quarter which were not deductible for income tax purposes. The liability for unrecognized tax benefits was $9.5 million at September 30, 2018, and $13.6 million at December 31, 2017. Included in the liability at September 30, 2018 were $1.7 million of tax positions for which ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility.

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the Act). While we substantially completed our analysis of the Act as of December 31, 2017, the amounts recorded for the Act remained provisional for the transition tax, the remeasurement of deferred taxes, our reassessment of permanently reinvested earnings, uncertain tax positions and valuation allowances. During the third quarter of 2018, we recorded a discrete tax benefit of $1.6 million for adjustments related to the transition tax, remeasurement of deferred taxes, and other items. There could be additional regulatory guidance issued or changes in the interpretations and assumptions taken that would adjust the provisional amounts recorded. We included an estimate of the current GILTI impact in our tax provision for 2018, however, we have not yet determined our policy election with respect to whether such taxes are recorded as a current period expense when incurred or whether such amounts should be factored into our measurement of its deferred taxes. Our analysis will be completed in the fourth quarter of 2018.

Note 11—Net Income per Common Share

The following summarizes the calculation of net income per common share attributable to common shareholders for the three and nine months ended September 30, 2018 and 2017.

(in thousands, except per share data)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Numerator:				
Net income (loss)	$(565)	$10,871	$(175,191)	$49,796
Less: income allocated to unvested restricted shares	—	(279)	—	(738)
Net income (loss) attributable to common shareholders - basic	(565)	10,592	(175,191)	49,058
Add: undistributed income attributable to unvested restricted shares - basic	—	—	—	16
Less: undistributed income attributable to unvested restricted shares - diluted	—	—	—	(16)
Net income (loss) attributable to common shareholders - diluted	$(565)	$10,592	$(175,191)	$49,058
Denominator:				
Weighted average shares outstanding - basic and diluted	59,766	59,849	59,996	60,010
Net income (loss) per share attributable to common shareholders: basic and diluted	$(0.01)	$0.18	$(2.92)	$0.82

Note 12—Shareholders' Equity

Our Board of Directors has authorized a share repurchase program of up to $100 million of our outstanding common stock to be executed at the discretion of management over a three-year period, expiring in December 2019. The timing of repurchases and the exact number of shares of common stock to be purchased will depend upon market conditions and other factors and may be suspended or discontinued at any time. Purchases under the share repurchase program are made either pursuant to 10b5-1 plans entered into by the company from time to time and/or during the company's scheduled quarterly trading windows for officers and directors. Our Credit Agreement contains restrictions on the amount and timing of share repurchase activity. This includes prohibiting share repurchases should a default under the Credit Agreement exist prior to or immediately after any share repurchases. There are also limitations depending upon our leverage ratio prior to any share repurchases or on a pro forma basis. We did not repurchase any shares during the nine months ended September 30, 2018. As of September 30, 2018, we have approximately $94.0 million remaining under the repurchase program. We have elected to allocate any excess of share repurchase price over par value to retained earnings.

Note 13—Accumulated Other Comprehensive Loss

The following table shows the changes in accumulated other comprehensive income (loss) by component for the three and nine months ended September 30, 2018 and 2017:

	Retirement Plans	Currency Translation Adjustments	Derivatives and Other	Total
Accumulated other comprehensive income (loss), June 30, 2018	$(11,312)	$(24,942)	$ 51	$(36,203)
Other comprehensive income (loss) before reclassifications	—	350	1,932	2,282
Income tax	—	—	(5)	(5)
Other comprehensive income (loss) before reclassifications, net of tax	—	350	1,927	2,277
Amounts reclassified from accumulated other comprehensive income (loss)	523	—	491	1,014
Income tax	(161)	—	(98)	(259)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	362	—	393	755
Other comprehensive income (loss)	362	350	2,320	3,032
Accumulated other comprehensive income (loss), September 30, 2018	$(10,950)	$(24,592)	$ 2,371	$(33,171)
Accumulated other comprehensive income (loss), June 30, 2017	$(10,743)	$(28,348)	$ 165	$(38,926)
Other comprehensive income (loss) before reclassifications	—	12,254	94	12,348
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	12,254	94	12,348
Amounts reclassified from accumulated other comprehensive income (loss)	456	—	—	456
Income tax	(220)	—	—	(220)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	236	—	—	236
Other comprehensive income (loss)	236	12,254	94	12,584
Accumulated other comprehensive income (loss), September 30, 2017	$(10,507)	$(16,094)	$ 259	$(26,342)

	Retirement Plans	Currency Translation Adjustments	Derivatives and Other	Total
Accumulated other comprehensive income (loss), December 31, 2017	$(12,066)	$(13,185)	$ 167	$(25,084)
Other comprehensive income (loss) before reclassifications	—	(11,407)	2,169	(9,238)
Income tax	—	—	(21)	(21)
Other comprehensive income (loss) before reclassifications, net of tax	—	(11,407)	2,148	(9,259)
Amounts reclassified from accumulated other comprehensive income (loss)	1,565	—	65	1,630
Income tax	(449)	—	(9)	(458)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	1,116	—	56	1,172
Other comprehensive income (loss)	1,116	(11,407)	2,204	(8,087)
Accumulated other comprehensive income (loss), September 30, 2018	$(10,950)	$(24,592)	$ 2,371	$(33,171)
Accumulated other comprehensive income (loss), December 31, 2016	$(11,209)	$(56,245)	$(29)	$(67,483)
Other comprehensive income (loss) before reclassifications	—	40,151	288	40,439
Income tax	—	—	—	—
Other comprehensive income (loss) before reclassifications, net of tax	—	40,151	288	40,439
Amounts reclassified from accumulated other comprehensive income (loss)	1,367	—	—	1,367
Income tax	(665)	—	—	(665)
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	702	—	—	702
Other comprehensive income (loss)	702	40,151	288	41,141
Accumulated other comprehensive income (loss), September 30, 2017	$(10,507)	$(16,094)	$ 259	$(26,342)

We include amounts reclassified out of accumulated other comprehensive income (loss) related to defined benefit pension plans as a component of net periodic pension cost recorded in distribution, selling and administrative expenses. For the three and nine months ended September 30, 2018, we reclassified $0.5 million and $1.6 million of actuarial net losses. For the three and nine months ended September 30, 2017, we reclassified $0.5 million and $1.4 million of actuarial net losses.

Note 14—Segment Information

We periodically evaluate our application of accounting guidance for reportable segments and disclose information about reportable segments based on the way management organizes the enterprise for making operating decisions and assessing performance. We report our business under two segments: Global Solutions and Global Products. The Global Solutions segment includes our United States and European distribution, logistics and value-added services business. Global Products provides product-related solutions, including surgical and procedural kitting and sourcing. The Halyard S&IP business, acquired on April 30, 2018, is a part of Global Products.

We evaluate the performance of our segments based on their operating income excluding acquisition-related and exit and realignment charges, certain purchase price fair value adjustments, and other substantive items that, either as a result of their nature or size, would not be expected to occur as part of our normal business operations on a regular basis. Beginning in the second quarter of 2018, the Company is excluding acquisition-related intangible amortization from the measure of segment operating income. This change is consistent with management's internal measure of segment results. Prior periods have been recast on a consistent basis.

Segment assets exclude inter-segment account balances as we believe their inclusion would be misleading and not meaningful. We believe all inter-segment sales are at prices that approximate market.

The following tables present financial information by segment:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net revenue:				
Segment net revenue				
Global Solutions	$2,243,782	$2,290,804	$6,875,077	$6,806,126
Global Products	349,895	124,542	750,770	392,654
Total segment net revenue	2,593,677	2,415,346	7,625,847	7,198,780
Inter-segment revenue				
Global Products	(128,800)	(81,385)	(330,120)	(270,339)
Total inter-segment revenue	(128,800)	(81,385)	(330,120)	(270,339)
Consolidated net revenue	$2,464,877	$2,333,961	$7,295,727	$6,928,441
Operating income (loss):				
Global Solutions	$24,150	$37,556	$84,742	$107,636
Global Products	27,634	10,510	61,351	30,199
Inter-segment eliminations	(2,957)	416	(3,032)	(266)
Goodwill and intangible asset impairment charges	—	—	(165,447)	—
Acquisition-related intangible amortization	(10,366)	(5,071)	(26,147)	(9,737)
Acquisition-related and exit and realignment charges	(7,727)	(9,299)	(47,416)	(21,134)
Other [1]	(9,377)	(4,441)	(30,527)	(8,674)
Consolidated operating income (loss)	$21,357	$29,671	$(126,476)	$98,024
Depreciation and amortization:				
Global Solutions	$15,829	$13,906	$47,464	$35,305
Global Products	13,953	1,947	26,132	5,755
Consolidated depreciation and amortization	$29,782	$15,853		