ArthroCare Reports Second Quarter 2012 Financial Results

The Associated Press

AUSTIN, Texas--(BUSINESS WIRE)--Aug 1, 2012--ArthroCare Corp. (NASDAQ: ARTC), a leader in developing state-of-the-art, minimally invasive surgical products, announced its financial results for the second quarter ended June 30, 2012.

SECOND QUARTER 2012 HIGHLIGHTS Total revenue of $91.7 million. Income from operations of $17.9 million, or operating margin of 19.6 percent. Net income available to common stockholders of $11.4 million, or $0.34 per diluted share. REVENUE Total revenue from continuing operations for the second quarter of 2012 was $91.7 million, compared to $91.3 million for the second quarter of 2011, an increase of 0.5 percent.

Product sales for the second quarter of 2012 were $87.5 million compared to $86.9 million in the second quarter of 2011, an increase of 0.6 percent. Product sales increased 2.7 percent in constant currency over the prior year.

Worldwide sales of Sports Medicine products increased $0.6 million or 1.0 percent. In constant currency, Sports Medicine product sales increased 3.4 percent this quarter when compared to the same quarter in 2011. In the Americas, Sports Medicine product sales increased $1.7 million which consisted of an increase in proprietary Sports Medicine product sales of $0.6 million, or 1.8 percent, and an increase in contract manufactured product sales of $1.1 million, or 20.8 percent. The increase in Americas Sports Medicine proprietary product sales is related to increases in our average selling prices due to distribution changes initiated in 2011. International Sports Medicine product sales decreased $1.1 million, or 5.5 percent, in the second quarter of 2012 compared to the same period in 2011 primarily as a result of the U.S. dollar strengthening against the euro, British pound, and Australian dollar.

Worldwide ENT product sales decreased $0.5 million, or 1.9 percent. In constant currency, ENT sales remained flat in the second quarter of 2012 as compared to the same quarter of 2011. Americas ENT product sales decreased $1.1 million or 4.9 percent primarily as a result of a decrease in product volume sold partially offset by an increase in average selling prices. International ENT product sales increased $0.6 million or 12.6 percent, primarily due to higher sales volumes in Asia Pacific markets partially offset by the effect of the U.S. dollar strengthening against the euro, British pound, and Australian dollar.

Other product sales increased $0.5 million in the second quarter of 2012 compared to the same quarter of 2011.

Across all product areas International product sales increased $0.4 million, or 1.5

percent in the second quarter of 2012 as compared to the same quarter of 2011. Had the same foreign currency rates been in effect in the quarter ended June 30, 2012 as were in effect in the second quarter in 2011, the U.S. dollar reported value of product sales would have been higher by $1.8 million for this quarter.

Management believes percentage sales growth in constant currency is an important metric for evaluating our operations because the impact of changing foreign currency exchange rates may not provide an accurate baseline for analyzing trends in our business. Percentage sales growth in constant currency is calculated by translating current year sales at prior year average foreign currency exchange rates. Constant currency is a non-GAAP measure and it should not be considered as a substitute for measures prepared in accordance with GAAP.

GROSS PRODUCT MARGIN Gross product margin was 68.7 percent for the second quarter of 2012 compared to 70.2 percent for the second quarter of 2011. The decrease in gross product margin in this quarter is due to lower reported product sales from International markets due to the weakening euro, British pound and Australian dollar against the U.S. dollar. Gross product margin was also lower due to the increasing proportion of Ambient® products to overall Sports Medicine Coblation® product sales. Ambient products have a lower yield and higher production cost compared to non-Ambient products.

INCOME FROM OPERATIONS Income from operations for the second quarter of 2012 was $17.9 million compared to $15.0 million for the same period in 2011. Operating margin for the second quarter of 2012 was 19.6 percent compared to 16.4 percent for the same period in 2011.

Under the short-term incentive plan for 2012 approved by the Board of Directors, Adjusted Operating Margin is a key metric for purposes of evaluating business performance. Adjusted Operating Margin is Operating Margin adjusted for investigation and restatement related costs. Investigation and restatement related costs were 1.2 percent and 4.3 percent of total revenue for the second quarters of 2012 and 2011, respectively, and Adjusted Operating Margin was 20.8 percent and 20.7 percent for these same periods. Adjusted Operating Margin is a non-GAAP measure of profitability and it should not be considered as a substitute for measures prepared in accordance with GAAP.

Total operating expenses were $46.4 million in the second quarter of 2012 compared to $50.4 million in the second quarter of 2011. Research and development expense increased $1.3 million and sales and marketing expense increased $1.6 million, offset by a decrease of $3.4 million in exit costs and a decrease of $2.8 million in investigation and restatement-related costs.

NET INCOME AVAILABLE TO COMMON STOCKHOLDERS Earnings per share from continuing operations applicable to common stockholders was $0.34 per diluted share in the second quarter of 2012 compared to $0.29 per diluted share in the second quarter of 2011.

Net income available to common stockholders in the second quarter of 2011

included income from discontinued operations of $1.6 million and earnings per share applicable to common stockholders was $11.4 million or $0.34 per diluted share in the second quarter of 2012, compared to $11.5 million, or $0.34 per diluted share, in the second quarter of 2011.

BALANCE SHEET AND CASH FLOWS Cash and cash equivalents was $181.2 million as of June 30, 2012 compared to $219.6 at December 31, 2011. In the first quarter of 2012, the Company paid $74 million as required under the proposed settlement of the private securities class actions. Excluding this payment, cash and cash equivalents increased $35.6 million during the six-months ended June 30, 2012. Cash used in operating activities for the six months ended June 30, 2012 was $33.0 million compared to cash flows provided by operating activities of $44.0 million for the six months ended June 30, 2011. Adjusting for the funding of the $74 million settlement of the private securities class actions, cash provided by operating activities in the first six months of 2012 would have been $41.0 million.

CONFERENCE CALL ArthroCare will hold a conference call with the financial community to present these results at 8:30 a.m. ET/5:30 a.m. PT on Thursday, August 2, 2012. To participate in the live conference call dial 855-724-2350. A live and on-demand webcast of the call will be available on ArthroCare’s Web site at www.arthrocare.com. A telephonic replay of the conference call can be accessed by dialing 800-633-8284 and entering pass code number 21600260. The replay will remain available through August 16, 2012.

ABOUT ARTHROCARE ArthroCare develops and manufactures surgical devices, instruments, and implants that strive to enhance surgical techniques as well as improve patient outcomes. Its devices improve many existing surgical procedures and enable new minimally invasive procedures. Many of ArthroCare’s devices use its internationally patented Coblation ® technology. This technology precisely dissolves target tissue and limits damage to surrounding healthy tissue. ArthroCare also develops surgical devices utilizing other patented technology including its OPUS ® line of fixation products as well as re-usable surgical instruments. ArthroCare is leveraging these technologies in order to offer a comprehensive line of surgical devices to capitalize on a multi-billion dollar market opportunity across several surgical specialties, including its two core product areas consisting of Sports Medicine and Ear, Nose, and Throat as well as other areas such as spine, wound care, urology and gynecology.

FORWARD-LOOKING STATEMENTS The information provided herein includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are not historical facts are forward-looking statements. Forward-looking statements are based on beliefs and assumptions by management and on information currently available to management. Forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update any of them publicly in light of new information or future events. Additional factors that could cause actual results to differ materially from those contained in any forward-looking statement include, without limitation: the resolution of litigation pending against the Company; the impact upon the Company’s operations of legal compliance matters which may

require improvement and remediation; the ability of the Company to control expenses relating to legal or compliance matters; the Company's ability to remain current in its periodic reporting requirements under the Exchange Act and to file required reports with the Securities and Exchange Commission on a timely basis; the results of the investigation being conducted by the United States Department of Justice; the impact on the Company of additional civil and criminal investigations by state and federal agencies and civil suits by private third parties involving the Company's financial reporting and its previously announced restatement and its insurance billing and healthcare fraud-and-abuse compliance practices; the results of the civil investigation by the Department of Justice related to the Civil Investigative Demand we received arising under the False Claims Act; the possibility that the Department of Justice could institute civil proceedings against us, based on the results of the investigation related to the Civil Investigative Demand; the risk that we could be subject to qui tam suits involving the False Claims Act; the possibility that the Department of Justice could institute a criminal enforcement action against us based on the results of the civil investigation related to the Civil Investigative Demand; the resolution of any litigation related to the civil investigation; the ability of the Company to attract and retain qualified senior management and to prepare and implement appropriate succession planning for its Chief Executive Officer; general business, economic and political conditions; competitive developments in the medical devices market; changes in applicable legislative or regulatory requirements; the Company's ability to effectively and successfully implement its business strategies, and manage the risks in its business; and the reactions of the marketplace to the foregoing. ARTHROCARE CORPORATION Condensed Consolidated Balance Sheets - Unaudited (in thousands, except par value data) June 30, December 31, 2012 2011 ASSETS Current assets: Cash and cash equivalents $ 181,246 $ 219,605 Accounts receivable, net of allowances of $2,149 and $2,251 at June 30, 2012 and December 31, 2011, respectively 45,718 51,350 Inventories, net 42,849 35,761 Deferred tax assets 31,332 40,622 Prepaid expenses and other current assets 6,283 5,532 Total current assets 307,428 352,870 Property and equipment, net 32,873 35,769 Intangible assets, net 4,007 5,457 Goodwill 119,398 119,159 Deferred tax assets 18,156 18,159 Other assets 1,634 1,587 Total assets $ 483,496 $ 533,001 LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable $ 14,077 $ 15,258 Accrued liabilities 34,691 112,586 Deferred Revenue 489 742 Deferred tax liabilities 74 - Income tax payable - 1,542 Total current liabilities 49,331 130,128 Deferred tax liabilities 286 29 Other non-current liabilities 19,110 18,922 Total liabilities 68,727 149,079 Commitments and contingencies (Notes 8 and 9) Series A 3% Redeemable Convertible Preferred Stock, par value $0.001; Authorized: 100 shares; Issued and outstanding: 75 shares at June 30, 2012 and December 31, 2011; Redemption value: $87,089 78,951 77,184 Stockholders' equity: Preferred stock, par value $0.001; Authorized: 4,900 shares; Issued and outstanding: none - - Common stock, par value $0.001; Authorized: 75,000 shares; Issued: 31,678 and 31,523 shares Outstanding: 27,720 and 27,562 shares at June 30, 2012 and December 31, 2011, respectively 28 28 Treasury stock: 3,955 and 3,968 shares at June 30, 2012 and December 31, 2011, respectively (106,781) (107,126) Additional paid-in capital 406,246 400,580 Accumulated other comprehensive income 4,229 4,615 Retained earnings 32,096 8,641 Total stockholders' equity

335,818 306,738 Total liabilities, redeemable convertible preferred stock and stockholders' equity $ 483,496 $ 533,001 This article has been truncated. You can see the rest of this article by visiting http://www.businesswire.com/news/home/20120801006401/en.

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