

IDEXX LABORATORIES INC /DE
Form 10-Q
May 01, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2019

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: 000-19271

IDEXX LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE 01-0393723
(State or other jurisdiction of incorporation (IRS Employer Identification No.)
or organization)

ONE IDEXX DRIVE, WESTBROOK, MAINE 04092
(Address of principal executive offices) (ZIP Code)

207-556-0300
(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 No

Indicate by check mark whether the registrant has submitted electronically 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 No

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 Accelerated filer
Non-accelerated filer Smaller reporting company

Emerging growth company

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.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares outstanding of the registrant's Common Stock, \$0.10 par value per share, was 86,006,332 on April 26, 2019.

GLOSSARY OF TERMS AND SELECTED ABBREVIATIONS

In order to aid the reader, we have included certain terms and abbreviations used throughout this Quarterly Report on Form 10-Q below:

Term/ Abbreviation	Definition
AOCI	Accumulated other comprehensive income or loss
ASU 2016-02	ASU 2016-02, Leases (Topic 842); also referred to as the “New Leasing Standard”
CAG	Companion Animal Group, a reporting segment that provides veterinarians diagnostic products and services and information management solutions that enhance the health and well-being of pets
Credit Facility	Our \$850 million five-year unsecured revolving credit facility under an amended and restated credit agreement that was executed in December 2015, also referred to as line of credit
FASB	U.S. Financial Accounting Standards Board
LPD	Livestock, Poultry and Dairy, a reporting segment that provides diagnostic products and services for livestock and poultry health and to ensure the quality and safety of milk and improve dairy efficiency
OPTI Medical	OPTI Medical Systems, Inc., a wholly-owned subsidiary of IDEXX Laboratories Inc., located in Roswell, Georgia. This business manufactures and supplies blood gas analyzers and consumables worldwide for the human point-of-care medical diagnostics market. The Roswell facility also manufactures electrolytes slides (instrument consumables) to run Catalyst One [®] , Catalyst Dx [®] , and blood gas analyzers and consumables for the veterinary market; also referred to as OPTI.
Organic revenue growth	A non-GAAP financial measure and represents the percentage change in revenue, as compared to the same period for the prior year, net of the effect of changes in foreign currency exchange rates, certain business acquisitions and divestitures. Organic revenue growth should be considered in addition to, and not as a replacement for or as a superior measure to, revenues reported in accordance with U.S. GAAP, and may not be comparable to similarly titled measures reported by other companies.
R&D	Research and Development
Reported revenue growth	Represents the percentage change in revenue reported in accordance with U.S. GAAP, as compared to the same period in the prior year
SaaS	Software-as-a-service
SEC	U.S. Securities and Exchange Commission
Senior Note Agreements	Note purchase agreements for the private placement of senior notes having an aggregate principal amount of approximately \$700 million, referred to as senior notes or long-term debt
U.S. GAAP	Accounting principles generally accepted in the United States of America
Water	Water, a reporting segment that provides water microbiology testing products

IDEXX LABORATORIES, INC.
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PART I— FINANCIAL INFORMATION

Item 1. Financial Statements.

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(Unaudited)

	March 31, 2019	December 31, 2018
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 116,616	\$ 123,794
Accounts receivable, net of reserves of \$4,566 in 2019 and \$4,702 in 2018	281,159	248,855
Inventories	189,468	173,303
Other current assets	110,403	108,220
Total current assets	697,646	654,172
Long-Term Assets:		
Property and equipment, net	449,103	437,270
Operating lease right-of-use assets (Notes 2 and 6)	80,594	—
Goodwill	214,517	214,489
Intangible assets, net	39,499	41,825
Other long-term assets	199,609	189,593
Total long-term assets	983,322	883,177
TOTAL ASSETS	\$ 1,680,968	\$ 1,537,349
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable	\$ 70,143	\$ 69,534
Accrued liabilities	229,127	260,683
Line of credit	346,998	398,937
Current portion of deferred revenue	43,351	41,290
Total current liabilities	689,619	770,444
Long-Term Liabilities:		
Deferred income tax liabilities	32,931	29,267
Long-term debt	699,334	601,348
Long-term deferred revenue, net of current portion	55,695	60,697
Long-term operating lease liabilities (Notes 2 and 6)	68,955	—
Other long-term liabilities	82,564	84,826
Total long-term liabilities	939,479	776,138
Total liabilities	1,629,098	1,546,582
Commitments and Contingencies (Note 14)		
Stockholders' Equity (Deficit):		
Common stock, \$0.10 par value: Authorized: 120,000 shares; Issued: 105,345 shares in 2019 and 105,087 shares in 2018; Outstanding: 86,054 shares in 2019 and 86,100 shares in 2018	10,535	10,509

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Additional paid-in capital	1,155,875	1,138,216
Deferred stock units: Outstanding: 162 units in 2019 and 2018	4,592	4,524
Retained earnings	1,270,609	1,167,928
Accumulated other comprehensive loss	(40,015)	(41,791)
Treasury stock, at cost: 19,290 shares in 2019 and 18,988 shares in 2018	(2,350,034)	(2,288,899)
Total IDEXX Laboratories, Inc. stockholders' equity (deficit)	51,562	(9,513)
Noncontrolling interest	308	280
Total stockholders' equity (deficit)	51,870	(9,233)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$1,680,968	\$ 1,537,349

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
Revenue:		
Product revenue	\$334,058	\$317,440
Service revenue	241,998	220,216
Total revenue	576,056	537,656
Cost of Revenue:		
Cost of product revenue	117,383	118,246
Cost of service revenue	127,076	116,311
Total cost of revenue	244,459	234,557
Gross profit	331,597	303,099
Expenses:		
Sales and marketing	106,584	100,101
General and administrative	60,361	60,931
Research and development	31,514	29,023
Income from operations	133,138	113,044
Interest expense	(8,386)	(9,274)
Interest income	40	579
Income before provision for income taxes	124,792	104,349
Provision for income taxes	22,083	14,873
Net income	102,709	89,476
Less: Net income attributable to noncontrolling interest	28	25
Net income attributable to IDEXX Laboratories, Inc. stockholders	\$102,681	\$89,451
Earnings per Share:		
Basic	\$1.19	\$1.02
Diluted	\$1.17	\$1.01
Weighted Average Shares Outstanding:		
Basic	86,204	87,331
Diluted	87,549	88,944

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
Net income	\$102,709	\$89,476
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(1,423)	5,165
Unrealized gain (loss) on net investment hedge	1,480	(2,216)
Unrealized gain on investments, net of tax expense of \$128 in 2019 and \$40 in 2018	407	118
Unrealized gain (loss) on derivative instruments:		
Unrealized gain (loss), net of tax expense (benefit) of \$531 in 2019 and \$(377) in 2018	2,474	(2,388)
Reclassification adjustment for (gain) loss included in net income, net of tax (expense) benefit of \$(249) in 2019 and \$250 in 2018	(1,162)	1,585
Unrealized gain (loss) on derivative instruments	1,312	(803)
Other comprehensive gain, net of tax	1,776	2,264
Comprehensive income	104,485	91,740
Less: Comprehensive income attributable to noncontrolling interest	28	25
Comprehensive income attributable to IDEXX Laboratories, Inc.	\$104,457	\$91,715

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

(in thousands, except per share amounts)

(Unaudited)

	Common Stock				Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interest	Total Stockholders' Equity (Deficit)
	Number of Shares	\$0.10 Par Value	Additional Paid-in Capital	Deferred Stock Units					
Balance December 31, 2017	104,275	\$10,428	\$1,073,931	\$5,988	\$803,545	\$(36,470)	\$(1,911,528)	\$264	\$(53,842)
Cumulative effect of accounting changes	—	—	—	—	(12,648)	—	—	—	(12,648)
Balance January 1, 2018	104,275	\$10,428	\$1,073,931	\$5,988	\$790,897	\$(36,470)	\$(1,911,528)	\$264	\$(66,490)
Net income	—	—	—	—	89,451	—	—	25	89,476
Other comprehensive income, net	—	—	—	—	—	2,264	—	—	2,264
Repurchases of common stock, net	—	—	—	—	—	—	(94,285)	—	(94,285)
Common stock issued under stock plans	401	40	14,311	(259)	—	—	—	—	14,092
Share-based compensation cost	—	—	5,917	43	—	—	—	—	5,960
Balance March 31, 2018	104,676	\$10,468	\$1,094,159	\$5,772	\$880,348	\$(34,206)	\$(2,005,813)	\$289	\$(48,983)
Balance December 31, 2018	105,087	10,509	1,138,216	4,524	1,167,928	(41,791)	(2,288,899)	280	(9,233)
Net income	—	—	—	—	102,681	—	—	28	102,709
Other comprehensive income, net	—	—	—	—	—	1,776	—	—	1,776
Repurchases of common stock, net	—	—	—	—	—	—	(61,135)	—	(61,135)
Common stock issued under stock plans	258	26	11,393	—	—	—	—	—	11,419
	—	—	6,266	68	—	—	—	—	6,334

Share-based
compensation
cost

Balance March 31, 2019	105,345	\$10,535	\$1,155,875	\$4,592	\$1,270,609	\$(40,015)	\$(2,350,034)	\$ 308	\$51,870
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The accompanying notes are an integral part of these consolidated financial statements.

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
Cash Flows from Operating Activities:		
Net income	\$ 102,709	\$ 89,476
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,355	20,804
Benefit of deferred income taxes	3,294	3,005
Share-based compensation expense	6,334	5,960
Other	628	1,091
Changes in assets and liabilities:		
Accounts receivable	(33,421)	(21,800)
Inventories	(14,521)	(8,070)
Other assets and liabilities	(49,601)	(52,302)
Accounts payable	699	(1,939)
Deferred revenue	(3,098)	(1,327)
Net cash provided by operating activities	34,378	34,898
Cash Flows from Investing Activities:		
Purchases of property and equipment	(38,206)	(23,726)
Purchase of marketable securities	—	(87)
Proceeds from the sale and maturities of marketable securities	—	284,125
Net cash (used) provided by investing activities	(38,206)	260,312
Cash Flows from Financing Activities:		
Repayments on revolving credit facilities, net	(52,024)	(247,500)
Issuance of senior notes	100,000	—
Debt issuance costs	(30)	—
Payment of acquisition-related contingent consideration	(573)	—
Repurchases of common stock	(54,302)	(83,487)
Proceeds from exercises of stock options and employee stock purchase plans	11,551	14,551
Shares withheld for statutory tax withholding on restricted stock	(7,403)	(8,555)
Net cash used by financing activities	(2,781)	(324,991)
Net effect of changes in exchange rates on cash	(569)	1,335
Net decrease in cash and cash equivalents	(7,178)	(28,446)
Cash and cash equivalents at beginning of period	123,794	187,675
Cash and cash equivalents at end of period	\$ 116,616	\$ 159,229

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying unaudited condensed consolidated financial statements of IDEXX Laboratories, Inc. and its subsidiaries have been prepared in accordance with U.S. GAAP for interim financial information and with the requirements of Regulation S-X, Rule 10-01 for financial statements required to be filed as a part of this Quarterly Report on Form 10-Q. Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "IDEXX," the "Company," "we," "our," or "us" refer to IDEXX Laboratories, Inc. and its subsidiaries.

The accompanying unaudited condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries. We do not have any variable interest entities for which we are the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of our management, all adjustments necessary for a fair statement of our financial position and results of operations. All such adjustments are of a recurring nature. The consolidated balance sheet data at December 31, 2018, was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three months ended March 31, 2019, are not necessarily indicative of the results to be expected for the full year or any future period. These unaudited condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, and our Annual Report on Form 10-K for the year ended December 31, 2018, (the "2018 Annual Report") filed with the SEC.

We have included certain terms and abbreviations used throughout this Quarterly Report on Form 10-Q in the "Glossary of Terms and Selected Abbreviations."

NOTE 2. ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these unaudited condensed consolidated financial statements for the three months ended March 31, 2019, are consistent with those discussed in Note 2 to the consolidated financial statements in our 2018 Annual Report, except as noted below.

New Accounting Pronouncements Adopted

We adopted ASU 2016-02, Leases (Topic 842) (the "New Leasing Standard"), as of January 1, 2019, using the optional transition method that allows for a cumulative-effect adjustment in the period of adoption and did not restate prior periods. In addition, we elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to carry forward the historical lease classification. The adoption of the New Leasing Standard resulted in the recording of operating lease liabilities of \$86.7 million and right-of-use assets of \$83.7 million. Prior to our adoption of the New Leasing Standard, rent prepayments of approximately \$1.0 million were recorded within other current assets and the impact of recognizing rent expense on a straight-line basis of approximately \$4.0 million was recorded within other current and long-term liabilities. Upon adoption of the New Leasing Standard, these rent prepayments and straight-line rent impacts are now recorded within

operating lease right-of-use assets and represent the net difference between operating lease liabilities and right-of-use assets.

The New Leasing Standard requires us to classify certain reagent rental programs as sales-type leases and thus accelerate instrument revenue and cost recognition at the time of instrument placement. We did not change the historical lease classification for placements prior to January 1, 2019, therefore this change will apply to certain new placements beginning on January 1, 2019. Under prior U.S. GAAP, instruments placed under our reagent rental programs were classified as operating leases and instrument revenue and cost was recognized over the term of the program. The New Leasing Standard did not have a material impact on our consolidated earnings and had no impact on cash flows for the three months ended March 31, 2019.

Adoption of the New Leasing Standard impacted our condensed consolidated balance sheet as follows:

Consolidated Balance Sheet

	Previous U.S. GAAP December 31, 2018 (Reported)	New U.S. GAAP January 1, 2019	Impact of the New Leasing Standard
ASSETS			
Other current assets	\$ 108,220	\$ 107,228	\$(992)
Total current assets	\$654,172	\$653,180	\$(992)
Operating lease right-of-use asset	\$—	\$83,707	\$83,707
Total long-term assets	\$883,177	\$966,884	\$83,707
TOTAL ASSETS	\$1,537,349	\$1,620,064	\$82,715
LIABILITIES			
Accrued liabilities	\$260,683	\$274,459	\$13,776
Total current liabilities	\$770,444	\$784,220	\$13,776
Long-term operating lease liability	\$—	\$68,939	\$68,939
Total long-term liabilities	\$776,138	\$845,077	\$68,939
TOTAL LIABILITIES	\$1,546,582	\$1,629,297	\$82,715

We adopted ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, on January 1, 2019. We elected not to reclassify the \$1.7 million of stranded tax effects from the Tax Cuts and Jobs Act enacted on December 22, 2017, from accumulated other comprehensive income to retained earnings in the period of adoption.

In August 2018, the SEC issued Final Rule Release No. 33-10532, “Disclosure Update and Simplification,” which makes a number of changes meant to simplify interim disclosures. The new rule requires a presentation of changes in stockholders’ equity and noncontrolling interest in the form of a reconciliation, either as a separate financial statement or in the notes to the financial statements, for the current and comparative year-to-date interim periods. The additional elements of this release did not have a material impact on our overall condensed consolidated financial statements. We adopted the new disclosure requirements in our Form 10-Q for the period ended March 31, 2019.

New Accounting Pronouncements Not Yet Adopted

For a discussion of other accounting standards that have been issued by the FASB prior to January 1, 2019, but are not yet effective, refer to Note 2. Summary of Significant Accounting Policies - New Accounting Pronouncements Not Yet Adopted in our 2018 Annual Report.

NOTE 3. REVENUE RECOGNITION

Our revenue is recognized when, or as, performance obligations under the terms of a contract are satisfied, which occurs when control of the promised products or services is transferred to a customer. We exclude sales, use, value-added, and other taxes we collect on behalf of third parties from revenue. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring products or services to a customer. To accurately present the consideration received in exchange for promised products or services, we applied the five-step model

outlined below:

1. Identification of a contract or agreement with a customer
2. Identification of our performance obligations in the contract or agreement
3. Determination of the transaction price
4. Allocation of the transaction price to the performance obligations
5. Recognition of revenue when, or as, we satisfy a performance obligation

We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. The timing of revenue recognition, billings, and cash collections results in accounts receivable, contract assets and lease receivables as a result of revenue recognized in advance of

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billings (included within other assets), and contract liabilities or deferred revenue as a result of receiving consideration in advance of revenue recognition within our unaudited condensed consolidated balance sheet. Our general payment terms range from 30 to 60 days, with exceptions in certain geographies. Below is a listing of our major categories of revenue for our products and services:

Diagnostic Products and Accessories. Diagnostic products and accessories revenues, including IDEXX VetLab consumables and accessories, rapid assay, LPD, Water, and OPTI testing products, are recognized and invoiced at the time of shipment, which is when the customer obtains control of the product based on legal title transfer and we have the right to payment. Shipping costs reimbursed by the customer are included in revenue and cost of sales. As a practical expedient, we do not account for shipping activities as a separate performance obligation.

Reference Laboratory Diagnostic and Consulting Services. Reference laboratory revenues are recognized and invoiced when the laboratory diagnostic service is performed.

Instruments, Software and Systems. CAG Diagnostics capital instruments, veterinary software and diagnostic imaging systems revenues are recognized and invoiced when the customer obtains control of the products based on legal title transfer and we have the right to payment, which generally occurs at the time of installation and customer acceptance. Our instruments, software, and systems are often included in one of our significant customer programs, as further described below. For veterinary software systems that include multiple performance obligations, such as perpetual software licenses and computer hardware, we allocate revenue to each performance obligation based on estimates of the price that we would charge the customer for each promised product or service if it were sold on a standalone basis.

Lease Revenue. Revenues from instrument rental agreements and reagent rental programs are recognized either as operating leases on a ratable basis over the term of the agreement or as sales-type leases at the time of installation and customer acceptance. Customers typically pay for the right to use instruments under rental agreements in equal monthly amounts over the term of the rental agreement. Our reagent rental programs provide our customers the right to use our instruments upon entering into agreements to purchase specified amounts of consumables, which are considered embedded leases. For some agreements, the customers are provided with the right to purchase the instrument at the end of the lease term. Lease revenues from these agreements are presented in product revenue on our unaudited condensed consolidated income statement. Lease revenue was approximately \$4.6 million and \$2.9 million for the three months ended March 31, 2019 and 2018, respectively, including both operating leases and sales-type leases under ASC 842, Leases, during 2019, and ASC 840, Leases, prior to 2019. See below for revenue recognition under our reagent rental programs.

Extended Warranties and Post-Contract Support. CAG Diagnostics capital instruments and diagnostic imaging systems extended warranties typically provide customers with continued coverage for a period of 1 to 5 years beyond the first-year standard warranty. Customers can either pay in full for the extended warranty at the time of instrument or system purchase or can be billed on a quarterly basis over the term of the contract. We recognize revenue associated with extended warranties over time on a ratable basis using a time elapsed measure of performance over the contract term, which approximates the expected timing in which applicable services are performed.

Veterinary software post-contract support provides customers with access to technical support when and as needed through access to call centers and online customer assistance. Post-contract support contracts typically have a term of 12 months and customers are billed for post-contract support in equal quarterly amounts over the term. We recognize revenue for post-contract support services over time on a ratable basis using a time-elapsed measure of performance over the contract term, which approximates the expected timing in which applicable services are performed.

On December 31, 2018, our deferred revenue related to extended warranties and post-contract support was \$40.7 million, of which approximately \$12.7 million was recognized during the three months ended March 31, 2019.

Furthermore, as a result of new agreements, our deferred revenue related to extended warranties and post-contract support was \$40.2 million at March 31, 2019. We do not disclose information about remaining performance obligations that are part of contracts with an original expected duration of one year or less and do not adjust for the effect of the financing components when the period between customer payment and revenue recognition is one year or less. Deferred revenue related to extended warranties and post-contract support with an original duration of more than one year was \$26.7 million at March 31, 2019, of which approximately 24%, 31%, 23% and 22% are expected to be recognized during the remainder of 2019, the full year 2020, the full year 2021, and thereafter, respectively. Additionally, we have determined these agreements do not include a significant financing component.

SaaS Subscriptions. We offer a variety of veterinary software and diagnostic imaging SaaS subscriptions including Neo, Animana, Pet Health Network Pro, Petly Plans, Web PACS, rVetLink, and Smart Flow. We recognize revenue for our SaaS subscriptions over time on a ratable basis over the contract term, beginning on the date our service is made available to the customer. Our subscription contracts vary in term from monthly to 2 years. Customers typically pay for our subscription contracts in equal monthly amounts over the term of the agreement. Deferred revenue related to our SaaS subscriptions is not material.

Contracts with Multiple Performance Obligations. We enter into contracts where customers purchase a combination of IDEXX products and services. Determining whether products and services are considered distinct performance obligations that should be accounted for separately requires significant judgment. We determine the transaction price for a contract based on the consideration we expect to receive in exchange for the transferred goods or services. To the extent the transaction price includes variable consideration, such as volume rebates or expected price adjustments, we apply judgment in constraining the estimated variable consideration due to factors that may cause reversal of revenue recognized. We evaluate constraints based on our historical and projected experience with similar customer contracts.

We allocate revenue to each performance obligation in proportion to the relative standalone selling prices and recognize revenue when transfer of the related goods or services has occurred for each obligation. We utilize the observable standalone selling price when available, which represents the price charged for the performance obligation when sold separately. When standalone selling prices for our products or services are not directly observable we determine the standalone selling prices using relevant information available and apply suitable estimation methods including, but not limited to, the cost plus a margin approach. We recognize revenue as each performance obligation is satisfied, either at a point in time or over time, as described in the revenue categories above. We do not disclose information about remaining performance obligations that are part of contracts with an original expected duration of one year or less.

The following customer programs represent our most significant customer contracts which contain multiple performance obligations:

Customer Commitment Programs. We offer customer incentives upon entering into multi-year agreements to purchase annual minimum amounts of products and services.

Up-Front Customer Loyalty Programs. Our up-front loyalty programs provide customers with incentives in the form of cash payments or IDEXX Points upon entering into multi-year agreements to purchase annual minimum amounts of future products or services. If a customer breaches its agreement, they are required to refund all or a portion of the up-front cash or IDEXX Points, or make other repayments, remedial actions, or both. Up-front incentives to customers in the form of cash or IDEXX Points are not made in exchange for distinct goods or services and are capitalized as customer acquisition costs within other assets, which are subsequently recognized as a reduction to revenue over the term of the customer agreement. If these up-front incentives are subsequently utilized to purchase instruments, we allocate total consideration, including future committed purchases less up-front incentives and estimates of expected price adjustments, based on relative standalone selling prices to identified performance obligations and recognize instrument revenue and cost at the time of installation and customer acceptance. We have determined these agreements do not include a significant financing component. Differences between estimated and actual customer purchases may impact the amount and timing of revenue recognition.

On December 31, 2018, our capitalized customer acquisition costs were \$124.4 million, of which approximately \$8.9 million was recognized as a reduction of revenue during the three months ended March 31, 2019. Furthermore, as a result of new up-front customer loyalty payments, our capitalized customer acquisition costs were \$125.2 million at March 31, 2019. We monitor customer purchases over the term of their agreement to assess the realizability of our capitalized customer acquisition costs and review estimates of variable consideration. Impairments, revenue

adjustments that relate to performance obligations satisfied in prior periods, and contract modifications during the three months ended March 31, 2019, were not material.

Volume Commitment Programs. Our volume commitment programs, such as our IDEXX 360 program, provide customers with a free or discounted instrument or system upon entering into multi-year agreements to purchase annual minimum amounts of products and services. We allocate total consideration, including future committed purchases and expected price adjustments, based on relative standalone selling prices to identified performance obligations and recognize instrument revenue and cost in advance of billing the customer at the time of installation and customer acceptance, which is also when the customer obtains

control of the instrument based on legal title transfer. Our right to future consideration related to instrument revenue is recorded as a contract asset within other current and long-term assets. The contract asset is transferred to accounts receivable when customers are billed for future products and services over the term of the contract. We have determined these agreements do not include a significant financing component. Differences between estimated and actual customer purchases may impact the amount and timing of revenue recognition.

On December 31, 2018, our volume commitment contract assets were \$40.9 million, of which approximately \$2.7 million was reclassified to accounts receivable when customers were billed for related products and services during the three months ended March 31, 2019. Furthermore, as a result of new placements under volume commitment programs, our contract assets were \$49.5 million at March 31, 2019. We monitor customer purchases over the term of their agreement to assess the realizability of our contract assets and review estimates of variable consideration. Impairments, revenue adjustments that relate to performance obligations satisfied in prior periods, and contract modifications during the three months ended March 31, 2019, were not material.

For our up-front customer loyalty and volume commitment programs, we estimate future revenues related to multi-year agreements to be approximately \$1.4 billion, of which approximately 20%, 23%, 19%, and 38% are expected to be recognized during the remainder of 2019, the full year 2020, the full year 2021, and thereafter, respectively. These future revenues relate to performance obligations not yet satisfied, for which customers have committed to purchase goods and services, net of the expected revenue reductions from customer acquisition costs and expected price adjustments, and as a result, are lower than stated contractual commitments by our customers.

Instrument Rebate Programs. Our instrument rebate programs, previously referred to as IDEXX Instrument Marketing Programs, require an instrument purchase and provide customers the opportunity to earn future rebates based on the volume of products and services they purchase over the term of the program. We account for the customer's right to earn rebates on future purchases as a separate performance obligation and determine the standalone selling price based on an estimate of rebates the customer will earn over the term of the program. Total consideration allocated to identified performance obligations is limited to goods and services that the customer is presently obligated to purchase and does not include estimates of future purchases that are optional. We allocate total consideration to identified performance obligations, including customer's right to earn rebates on future purchases, which is deferred and recognized upon the purchase of future products and services, offsetting future rebates as they are earned.

On December 31, 2018, our deferred revenue related to instrument rebate programs was \$57.4 million, of which approximately \$4.9 million was recognized when customers purchased eligible products and services and earned rebates during the three months ended March 31, 2019. Furthermore, as a result of new instrument purchases under rebate programs, our deferred revenue was \$55.0 million at March 31, 2019, of which approximately 24%, 28%, 22%, and 26% are expected to be recognized during the remainder of 2019, the full year 2020, the full year 2021, and thereafter, respectively.

Reagent Rental Programs. Our reagent rental programs provide our customers the right to use our instruments upon entering into multi-year agreements to purchase annual minimum amounts of consumables. These types of agreements include an embedded lease for the right to use our instrument and we determine the amount of lease revenue allocated to the instrument based on relative standalone selling prices. We evaluate the terms of these embedded leases to determine classification as either a sales-type lease or an operating lease, as defined within the New Leasing Standard. We elected the package of practical expedients permitted under the transition guidance within the New Leasing Standard, which among other things, allowed us to carryforward our historical lease classification and therefore all reagent rental program placements prior to January 1, 2019 will continue to be classified as operating leases. We have not elected the practical expedient within the New Leasing Standard to combine lease and non-lease components.

Sales-type Reagent Rental Programs. Our reagent rental programs that effectively transfer control of instruments to our customers are classified as sales-type leases and we recognize instrument revenue and cost in advance of billing the customer, at the time of installation and customer acceptance. Our right to future consideration related to instrument revenue is recorded as a lease receivable within other current and long-term assets, and is transferred to accounts receivable when customers are billed for future products and services over the term of the contract. As a result of new placements under reagent rental programs, our lease receivable assets were \$1.3 million at March 31, 2019. The impact of discounting and unearned income at March 31, 2019 were not material. Profit and loss recognized at the commencement date and interest income

during the three months ended March 31, 2019 were not material. We monitor customer purchases over the term of their agreement to assess the realizability of our lease receivable assets. Impairments during the three months ended March 31, 2019 were not material.

Operating-type Reagent Rental Programs. Our reagent rental programs that do not effectively transfer control of instruments to our customers are classified as operating leases and we recognize instrument revenue and costs ratably over the term of the agreement. The cost of the instrument is capitalized within property and equipment. During the three months ended March 31, 2019 and 2018, we transferred instruments of \$2.0 million and \$4.0 million, respectively from inventory to property and equipment.

We estimate future revenue to be recognized related to our reagent rental programs of approximately \$38.1 million, of which approximately 30%, 32%, 23%, and 15% are expected to be recognized during the remainder of 2019, the full year 2020, the full year 2021, and thereafter, respectively. These future revenues relate to performance obligations not yet satisfied for which customers have committed to future purchases, net of any expected price adjustments, and as a result, may be lower than stated contractual commitments by our customers.

Other Customer Incentive Programs. Certain agreements with customers include discounts or rebates on the sale of products and services applied retrospectively, such as volume rebates achieved by purchasing a specified purchase threshold of goods and services. We account for these discounts as variable consideration and estimate the likelihood of a customer meeting the threshold in order to determine the transaction price using the most predictive approach. We typically use the most-likely-amount method, for incentives that are offered to individual customers, and the expected-value method, for programs that are offered to a broad group of customers. Revenue adjustments that relate to performance obligations satisfied in prior periods during the three months ended March 31, 2019, were not material. Refund obligations related to customer incentive programs are recorded in accrued liabilities for the actual issuance of incentives, incentives earned but not yet issued and estimates of incentives to be earned in the future.

Program Combinations. At times, we combine elements of our significant customer programs within a single customer contract. We separate each significant program element and include the contract assets, customer acquisition costs, deferred revenues and estimated future revenues within the most relevant program disclosures above. Each customer contract is presented as a net contract asset or net contract liability on our unaudited condensed consolidated balance sheet.

Future market conditions and changes in product offerings may cause us to change marketing strategies to increase or decrease customer incentive offerings, possibly resulting in incremental reductions of revenue in future periods as compared to reductions in the current or prior periods. Additionally, certain customer programs require us to estimate, based on historical experience, and apply judgment to predict the amounts of future customer purchases, customer rebates and other incentive payments, and price adjustments related to multi-year agreements. Differences between estimated and actual customer purchases may impact the amount and timing of revenue recognition.

IDEXX Points. IDEXX Points may be applied to trade receivables due to us, converted to cash, or applied against the purchase price of IDEXX products and services. We consider IDEXX Points equivalent to cash. IDEXX Points that have not yet been used by customers are included in accrued liabilities until utilized or expired. Breakage is not material because customers can apply IDEXX Points to trade receivables at any time.

Accounts Receivable. We recognize revenue when it is probable that we will collect substantially all of the consideration to which we will be entitled, based on the customer's intent and ability to pay the promised consideration. We apply judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer. We maintain allowances for doubtful accounts for

potentially uncollectible receivables. We base our estimates on a detailed analysis of specific customer situations and a percentage of our accounts receivable by aging category. Additional allowances may be required if either the financial condition of our customers were to deteriorate, or a strengthening U.S. dollar impacts the ability of foreign customers to make payments to us on their U.S. dollar-denominated purchases. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered. We do not have any off-balance sheet credit exposure related to our customers. We have no significant customers that accounted for greater than 10% of our consolidated revenues and we have no concentration of credit risk as of March 31, 2019.

Disaggregated Revenues. We present disaggregated revenue for our CAG segment based on major product and service categories. Our Water segment is comprised of a single major product category. Although our LPD segment does not meet the quantitative thresholds to be reported as a separate segment, we believe it is important to disaggregate these revenues as a major product and service category within our Other reportable segment given its distinct markets, and therefore we have elected to report LPD as a reportable segment.

The following table presents disaggregated revenue by major product and service categories for the three months ended March 31, 2019 and 2018 (in thousands):

	For the Three Months Ended March 31,	
	2019	2018
CAG segment revenue:		
CAG Diagnostics recurring revenue:	\$443,791	\$406,048
IDEXX VetLab consumables	167,211	149,513
Rapid assay products	54,431	52,017
Reference laboratory diagnostic and consulting services	202,658	186,937
CAG Diagnostics service and accessories	19,491	17,581
CAG Diagnostics capital - instruments	28,749	30,895
Veterinary software, services and diagnostic imaging systems	36,378	33,890
CAG segment revenue	508,918	470,833
Water segment revenue	30,310	29,143
LPD segment revenue	31,506	32,240
Other segment revenue	5,322	5,440
Total revenue	\$576,056	\$537,656

Revenue by principal geographic area, based on customers' domiciles, was as follows (in thousands):

	For the Three Months Ended March 31,	
	2019	2018
United States	\$358,288	\$327,461
Europe, the Middle East and Africa	121,746	120,574
Asia Pacific Region	60,075	56,039
Canada	23,224	22,544
Latin America	12,723	11,038
Total	\$576,056	\$537,656

Costs to Obtain a Contract. We capitalize sales commissions and the related fringe benefits earned by our sales force when considered incremental and recoverable costs of obtaining a contract. Our contracts include performance obligations related to various goods and services, some of which are satisfied at a point in time and others over time. Commission costs related to performance obligations satisfied at a point in time are expensed at the time of sale, which is when revenue is recognized. Commission costs related to long-term service contracts and performance obligations satisfied over time, including extended warranties and SaaS subscriptions, are deferred and recognized on a systematic basis that is consistent with the transfer of the goods or services to which the asset relates. We apply judgment in estimating the amortization period, which ranges from 3 to 7 years, by taking into consideration our customer contract terms, history of renewals, expected length of customer relationship, as well as the useful life of the underlying technology and products. Amortization expense is included in sales and marketing expenses in the accompanying unaudited condensed consolidated statements of income. Deferred commission costs are periodically

reviewed for impairment.

On December 31, 2018, our deferred commission costs, included within other assets, were \$13.9 million, of which approximately \$1.2 million of commission expense was recognized during the three months ended March 31, 2019. Furthermore, as a result of commissions related to new extended warranties and SaaS subscriptions, our deferred commission costs were \$14.4 million at March 31, 2019. Impairments of deferred commission costs during the three months ended March 31, 2019, were not material.

NOTE 4. SHARE-BASED COMPENSATION

The fair value of options, restricted stock units, deferred stock units, and employee stock purchase rights awarded during the three months ended March 31, 2019, totaled \$34.4 million as compared to \$31.1 million for the three months ended March 31, 2018. The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at March 31, 2019, was \$73.4 million, which will be recognized over a weighted average period of approximately 2.3 years. During the three months ended March 31, 2019, we recognized expenses of \$6.3 million as compared to \$6.0 million for the three months ended March 31, 2018, related to share-based compensation.

We determine the assumptions used in the valuation of option awards as of the date of grant. Differences in the expected stock price volatility, expected term or risk-free interest rate may necessitate distinct valuation assumptions at each grant date. As such, we may use different assumptions for options granted throughout the year. Option awards are granted with an exercise price equal to the closing market price of our common stock at the date of grant. We have never paid any cash dividends on our common stock, and we have no intention to pay such a dividend at this time; therefore, we assume that no dividends will be paid over the expected terms of option awards.

The weighted averages of the valuation assumptions used to determine the fair value of each option award on the date of grant and the weighted average estimated fair values were as follows:

	For the Three Months Ended March 31,			
	2019		2018	
Share price at grant	\$206.94		\$178.26	
Expected stock price volatility	26	%	24	%
Expected term, in years	6.0		5.8	
Risk-free interest rate	2.5	%	2.7	%
Weighted average fair value of options granted	\$63.55		\$52.49	

NOTE 5. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The components of inventories were as follows (in thousands):

	March 31, December 31,	
	2019	2018
Raw materials	\$ 32,869	\$ 31,973
Work-in-process	20,077	17,009
Finished goods	136,522	124,321
Inventories	\$ 189,468	\$ 173,303

NOTE 6. LEASES

The majority of our facilities are occupied under operating lease arrangements with various expiration dates through 2067, some of which include options to extend the life of the lease, and some of which include options to terminate the lease within 1 year. In certain instances, we are responsible for the real estate taxes and operating expenses related

to these facilities. Additionally, we enter into operating leases for certain vehicles and office equipment in the normal course of business. We determine the expected term of any executed agreements using the non-cancelable lease term plus any renewal options by which the failure to renew imposes a penalty in such amount that renewal is reasonably assured. The derived expected term is then used in the determination of a financing or operating lease and in the calculation of straight-line rent expense. Rent escalations are considered in the calculation of minimum lease payments in our capital lease tests and in determining straight-line rent expense for operating leases. Minimum lease payments include the fixed lease component of the agreement, as well as fixed rate increases that are initially measured at the lease commencement date. Variable lease payments based on an index, payments associated with non-lease components and short-term rentals (leases with terms less than 12

months) are expensed as incurred. Consideration is allocated to the lease and non-lease components based on the estimated standalone prices.

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use assets, accrued liabilities, and long-term operating lease liabilities in our consolidated balance sheets. Our financing leases are not material to our financial statements.

Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease liabilities and right-of-use assets are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an explicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Rent expense for lease payments is recognized on a straight-line basis over the lease term. The operating lease right-of-use assets also includes any rent prepayments, lease incentives upon receipt and straight-line rent expense impacts, which represent the difference between our operating lease liabilities and right-of-use assets.

Maturities of operating lease liabilities were as follows (in thousands, except lease term and discount rate):

	March 31, 2019
2019 (remainder of year)	\$12,308
2020	17,414
2021	14,821
2022	11,175
2023	7,705
Thereafter	37,722
Total lease payments	101,145
Less imputed interest	(18,258)
Total	\$82,887
Current operating lease liabilities, included in accrued liabilities	\$13,932
Long-term operating lease liabilities	\$68,955
Weighted average remaining lease term - operating leases	10.9 years
Weighted average discount rate - operating leases	3.7 %

Rent expense charged to operations under operating leases was approximately \$5.2 million during the three months ended March 31, 2019. Variable rent and short term lease expenses were not material.

Supplemental cash flow information for leases was as follows (in thousands):

For the
Three
Months
Ended
March
31,

2019

Cash paid for amounts included in the measurement of operating leases liabilities \$ 5,728

Right-of-use assets obtained in exchange for operating lease obligations \$ 2,196

At December 31, 2018, under ASC 840 Leases, the minimum annual rental payments under our lease agreements were as follows: \$19.4 million in 2019; \$17.1 million in 2020; \$14.5 million in 2021; \$10.8 million in 2022; \$8.5 million in 2023; and \$36.5 million thereafter.

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NOTE 7. OTHER CURRENT AND LONG-TERM ASSETS

Other current assets consisted of the following (in thousands):

	March 31, December 31,	
	2019	2018
Prepaid expenses (Note 2)	\$ 31,593	\$ 30,314
Taxes receivable	13,813	14,098
Customer acquisition costs	35,495	34,515
Contract assets	11,669	9,670
Deferred sales commissions	4,664	4,464
Other assets	13,169	15,159
Other current assets	\$ 110,403	\$ 108,220

Other long-term assets consisted of the following (in thousands):

	March 31, December 31,	
	2019	2018
Investment in long-term product supply arrangements	\$ 11,621	\$ 10,894
Customer acquisition costs	89,690	89,862
Contract assets	37,839	31,269
Deferred sales commissions	9,731	9,470
Deferred income taxes	8,368	8,481
Other assets	42,360	39,617
Other long-term assets	\$ 199,609	\$ 189,593

NOTE 8. ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

	March 31, December 31,	
	2019	2018
Accrued expenses (Note 2)	\$ 58,589	\$ 65,212
Accrued employee compensation and related expenses	60,351	109,488
Accrued taxes	36,326	26,609
Accrued customer incentives and refund obligations	59,929	59,374
Current lease liabilities (Notes 2 and 6)	13,932	—
Accrued liabilities	\$ 229,127	\$ 260,683

Other long-term liabilities consisted of the following (in thousands):

	March 31, December 31,	
	2019	2018
Accrued taxes	\$ 67,525	\$ 66,767
Other accrued long-term expenses (Note 2)	15,039	18,059
Other long-term liabilities	\$ 82,564	\$ 84,826

NOTE 9. DEBT

On December 19, 2014, we entered into a Multicurrency Note Purchase and Private Shelf Agreement among ourselves, Metropolitan Life Insurance Company ("MetLife"), and each of the accredited institutional purchasers named therein (the "Existing Agreement"). Pursuant to the terms of the Existing Agreement, we may request that MetLife purchase, over the three-year period beginning on December 19, 2014, up to \$50 million of additional senior promissory notes of ours at a fixed interest rate and with a maturity date not to exceed fifteen years (the "Shelf Notes").

On March 14, 2019, we amended the Existing Agreement to (i) increase the Shelf Notes facility size from \$50 million to \$150 million, (ii) extend the Shelf Notes facility issuance period from December 19, 2017 to December 20, 2021 and (iii) make various implementing and administrative changes in order to facilitate a \$100 million Shelf Notes issuance on March 14, 2019. We also submitted to MetLife a request to purchase \$100 million of our Shelf Notes at a 4.19% per annum rate, due March 14, 2029, (the "Series C Notes"). We used the proceeds received from the Series C Notes for general corporate purposes, including a partial repayment of borrowings under our Credit Facility.

NOTE 10. REPURCHASES OF COMMON STOCK

We primarily acquire shares by repurchases in the open market. However, we also acquire shares that are surrendered by employees in payment for the minimum required statutory withholding taxes due on the vesting of restricted stock units and the settlement of deferred stock units, otherwise referred to herein as employee surrenders. We issue shares of treasury stock upon the vesting of certain restricted stock units and upon the exercise of certain stock options. The number of shares of treasury stock issued during the three months ended March 31, 2019 and 2018, was not material.

The following is a summary of our open market common stock repurchases, reported on a trade date basis, and shares acquired through employee surrender for the three months ended March 31, 2019 and 2018 (in thousands, except per share amounts):

	For the Three Months Ended March 31,	
	2019	2018
Shares repurchased in the open market	267	465
Shares acquired through employee surrender for statutory tax withholding	36	48
Total shares repurchased	303	513
Cost of shares repurchased in the open market	\$53,862	\$86,188
Cost of shares for employee surrenders	7,403	8,555
Total cost of shares	\$61,265	\$94,743
Average cost per share - open market repurchases	\$201.41	\$185.23
Average cost per share - employee surrenders	\$206.35	\$178.83
Average cost per share - total	\$202.00	\$184.63

NOTE 11. INCOME TAXES

Our effective income tax rate was 17.7% for the three months ended March 31, 2019, as compared to 14.3% for the three months ended March 31, 2018. The increase in our effective tax rate was primarily related to lower tax benefits from share-based compensation, partially offset by a nonrecurring item recorded in the three months ended March 31, 2018, that resulted from the 2017 Tax Cut and Jobs Act.

NOTE 12. ACCUMULATED OTHER COMPREHENSIVE INCOME

The changes in AOCI, net of tax, for the three months ended March 31, 2019, consisted of the following (in thousands):

For the Three Months Ended March 31, 2019	Unrealized (Loss) Gain on Investments, Net of Tax	Unrealized Gain (Loss) on Derivative Instruments, Net of Tax	Unrealized (Loss) Gain on Net Investment Hedge, Net of Tax	Cumulative Translation Adjustment	Total
Balance as of December 31, 2018	\$ (157)	\$ 7,589	\$ (394)	\$ (48,829)	\$ (41,791)
Other comprehensive income (loss) before reclassifications	407	2,474	1,480	(1,423)	2,938
Gains reclassified from accumulated other comprehensive income	—	(1,162)	—	—	(1,162)
Balance as of March 31, 2019	\$ 250	\$			