CRYOLIFE INC
Form 10-Q
October 27, 2015

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, 2015**

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: 1-13165

CRYOLIFE, INC.

(Exact name of registrant as specified in its charter)

Florida	**59-2417093**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1655 Roberts Boulevard, NW, Kennesaw, Georgia	**30144**
(Address of principal executive offices)	(Zip Code)

(770) 419-3355

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90

days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at October 22, 2015**
Common Stock, $.01 par value per share	28,454,868 Shares

Part I FINANCIAL INFORMATION

Item 1. Financial Statements.

CRYOLIFE, INC. AND SUBSIDIARIES

SUMMARY CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Unaudited)		(Unaudited)	
Revenues:				
Products	$ 19,859	$ 20,405	$ 59,168	$ 60,210
Preservation services	16,844	16,664	46,892	47,280
Total revenues	**36,703**	**37,069**	**106,060**	**107,490**
Cost of products and preservation services:				
Products	4,278	4,167	13,555	12,099
Preservation services	9,443	9,103	28,302	26,735
Total cost of products and preservation services	**13,721**	**13,270**	**41,857**	**38,834**
Gross margin	**22,982**	**23,799**	**64,203**	**68,656**
Operating expenses:				
General, administrative, and marketing	17,494	18,882	55,790	55,116
Research and development	2,960	1,902	7,896	6,607
Total operating expenses	**20,454**	**20,784**	**63,686**	**61,723**
Operating income	**2,528**	**3,015**	**517**	**6,933**
Interest expense	(78)	65	(18)	110
Interest income	(14)	(1)	(29)	(49)
Gain on sale of Medafor investment	--	--	(891)	--
Other (income) expense, net	(238)	4	204	(206)

Income before income taxes	**2,858**	**2,947**	**1,251**	**7,078**
Income tax expense (benefit)	713	621	(118)	1,532
Net income	$ **2,145**	$ **2,326**	$ **1,369**	$ **5,546**
Income per common share:				
Basic	$ **0.08**	$ **0.08**	$ **0.05**	$ **0.20**
Diluted	$ **0.07**	$ **0.08**	$ **0.05**	$ **0.19**
Dividends declared per common share	$ **0.0300**	$ **0.0300**	$ **0.0900**	$ **0.0875**
Weighted-average common shares outstanding:				
Basic	27,823	27,367	27,687	27,414
Diluted	28,596	28,268	28,487	28,345
Net income	$ **2,145**	$ **2,326**	$ **1,369**	$ **5,546**
Other comprehensive loss	(349)	(80)	(124)	(73)
Comprehensive income	$ **1,796**	$ **2,246**	$ **1,245**	$ **5,473**

See accompanying Notes to Summary Consolidated Financial Statements.

CRYOLIFE, INC. AND SUBSIDIARIES

SUMMARY CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 38,497	$ 33,375
Restricted securities	848	884
Receivables, net	24,443	22,863
Inventories	14,432	12,739
Deferred preservation costs	23,480	25,196
Deferred income taxes	5,729	6,210
Prepaid expenses and other	5,399	4,761
Total current assets	**112,828**	**106,028**
Property and equipment, net	12,036	12,002
Restricted cash	5,000	5,000
Goodwill	11,365	11,365
Patents, net	1,446	1,784
Trademarks and other intangibles, net	17,713	19,496
Deferred income taxes	14,141	15,659
Other	5,452	4,823
Total assets	**$ 179,981**	**$ 176,157**
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,637	$ 4,543
Accrued compensation	7,952	5,406
Accrued procurement fees	4,683	4,675
Accrued expenses and other	4,596	5,583
Deferred income	362	420
Total current liabilities	**22,230**	**20,627**
Other	5,858	6,845
Total liabilities	**28,088**	**27,472**

Commitments and contingencies		
Shareholders equity:		
Preferred stock	--	--
Common stock (issued shares of 29,719 in 2015 and 29,229 in 2014)	297	292
Additional paid-in capital	141,480	135,227
Retained earnings	21,584	22,768
Accumulated other comprehensive loss	(245)	(121)
Treasury stock at cost (shares of 1,265 in 2015 and 1,101 in 2014)	(11,223)	(9,481)
Total shareholders equity	**151,893**	**148,685**
Total liabilities and shareholders equity	**$ 179,981**	**$ 176,157**

See accompanying Notes to Summary Consolidated Financial Statements.

CRYOLIFE, INC. AND SUBSIDIARIES

SUMMARY CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Nine Months Ended September 30,	
	2015	**2014**
	(Unaudited)	
Net cash flows from operating activities:		
Net income	$ 1,369	$ 5,546
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	4,539	4,468
Non-cash compensation	3,727	2,736
Gain on sale of Medafor investment	(891)	--
Other non-cash adjustments to income	3,314	(544)
Changes in operating assets and liabilities:		
Receivables	(1,580)	(3,288)
Inventories and deferred preservation costs	(692)	(2,123)
Prepaid expenses and other assets	(1,267)	(3,156)
Accounts payable, accrued expenses, and other liabilities	1,508	(306)
Net cash flows provided by operating activities	**10,027**	**3,333**
Net cash flows from investing activities:		
Capital expenditures	(3,186)	(3,225)
Proceeds from sale of Medafor investment	891	--
Other	(508)	(1,582)
Net cash flows used in investing activities	**(2,803)**	**(4,807)**
Net cash flows from financing activities:		
Cash dividends paid	(2,553)	(2,452)
Proceeds from exercise of stock options and issuance of common stock	1,408	1,409
Repurchases of common stock	--	(4,584)
Other	(809)	(677)
Net cash flows used in financing activities	**(1,954)**	**(6,304)**
Effect of exchange rate changes on cash	(148)	(42)

Increase (decrease) in cash and cash equivalents	**5,122**	**(7,820)**
Cash and cash equivalents, beginning of period	33,375	37,643
Cash and cash equivalents, end of period	**$ 38,497**	**$ 29,823**

See accompanying Notes to Summary Consolidated Financial Statements.

CRYOLIFE, INC. AND SUBSIDIARIES

NOTES TO SUMMARY CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

The accompanying summary consolidated financial statements include the accounts of CryoLife, Inc. and its subsidiaries (CryoLife, the Company, we, or us). All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying Summary Consolidated Balance Sheet as of December 31, 2014 has been derived from audited financial statements. The accompanying unaudited summary consolidated financial statements as of and for the three and nine months ended September 30, 2015 and 2014 have been prepared in accordance with (i) accounting principles generally accepted in the U.S. for interim financial information and (ii) the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the U.S. Securities and Exchange Commission (SEC). Accordingly, such statements do not include all of the information and disclosures required by accounting principles generally accepted in the U.S. for a complete presentation of financial statements. In the opinion of management, all adjustments (including those of a normal, recurring nature) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. These summary consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in CryoLife s Annual Report on Form 10-K for the year ended December 31, 2014.

2. Financial Instruments

The following is a summary of the Company s financial instruments measured at fair value (in thousands):

September 30, 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Restricted securities:				
Money market funds	$ 848	$ --	$ --	$ 848
Total assets	$ 848	$ --	$ --	$ 848

December 31, 2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash equivalents:				
Money market funds	$ 18,213	$ --	$ --	$ 18,213
Restricted securities:				
Money market funds	884	--	--	884
Total assets	$ 19,097	$ --	$ --	$ 19,097

The Company used prices quoted from its investment management companies to determine the Level 1 valuation of its investments in money market funds.

3. Cash Equivalents and Restricted Cash and Securities

The following is a summary of cash equivalents and restricted cash and securities (in thousands):

September 30, 2015	Cost Basis	Unrealized Holding Gains	Estimated Market Value
Restricted cash and securities:			
Cash	$ 5,000	$ --	$ 5,000
Money market funds	848	--	848

December 31, 2014	Cost Basis	Unrealized Holding Gains	Estimated Market Value
Cash equivalents:			
Money market funds	$ 18,213	$ --	$ 18,213
Restricted cash and securities:			
Cash	5,000	--	5,000
Money market funds	884	--	884

As of September 30, 2015 and December 31, 2014 $848,000 and $884,000, respectively, of the Company s money market funds were designated as short-term restricted securities due to a contractual commitment to hold the securities as pledged collateral relating primarily to international tax obligations. As of September 30, 2015 and December 31, 2014 $5.0 million of the Company s cash was designated as long-term restricted cash due to a financial covenant requirement under the Company s credit agreement with General Electric Capital Corporation (GE Capital), as discussed in Note 11. This restriction will lapse upon expiration of the credit agreement with GE Capital on September 26, 2019.

There were no gross realized gains or losses on cash equivalents in the three and nine months ended September 30, 2015 and 2014. As of September 30, 2015 $240,000 of the Company s restricted securities had a maturity date within three months and $608,000 had a maturity date between three months and one year. As of December 31, 2014 $622,000 of the Company s restricted securities had a maturity date within three months and $262,000 had a maturity date between three months and one year. As of September 30, 2015 and December 31, 2014 $5.0 million of the Company s long-term restricted cash had no maturity date.

4. Distribution Agreements

ProCol Distribution Agreement

In 2014 CryoLife acquired the exclusive worldwide distribution rights to ProCol® Vascular Bioprosthesis (ProCol) from Hancock Jaffe Laboratories, Inc. (Hancock Jaffe). The agreement between CryoLife and Hancock Jaffe (the HJ Agreement) has an initial three-year term and is renewable for two one-year periods at CryoLife s option. Per the terms of the HJ Agreement, CryoLife has the option to acquire the ProCol product line from Hancock Jaffe beginning in March 2016.

ProCol, which is approved for sale in the U.S., is a biological graft derived from a bovine mesenteric vein that provides vascular access for end-stage renal disease (ESRD) hemodialysis patients. It is intended for the creation of a bridge graft for vascular access subsequent to at least one previously failed prosthetic access graft. ProCol is complementary to the Company s Hemodialysis Reliable Outflow Graft (HeRO® Graft), which also serves patients with ESRD; however, ProCol provides vascular access for ESRD patients in an earlier-stage of treatment protocol than the HeRO Graft.

In accordance with the terms of the HJ Agreement, CryoLife made payments to Hancock Jaffe of $1.7 million during 2014 and $576,000 in January 2015. In exchange for these payments, CryoLife obtained the right to receive a designated amount of ProCol inventory for resale, a portion of which the Company received in 2014 and 2015. Subsequent to this initial inventory purchase, CryoLife can purchase additional units from Hancock Jaffe at an agreed upon transfer price. The Company began limited distribution of ProCol in the second quarter of 2014. On September 29, 2014 Hancock Jaffe received U.S. Food and Drug Administration (FDA) approval of the Premarket Approval (PMA) Supplement associated with its new manufacturing facility, and the Company began shipping product made in this new facility in the fourth quarter of 2014.

CryoLife made additional payments of $735,000 in the aggregate during the second and third quarters of 2015. As of September 30, 2015 CryoLife had made a total of $3.0 million in payments to Hancock Jaffe and had received $1.2 million in inventory. Therefore, as of September 30, 2015 CryoLife had approximately $1.8 million in remaining prepayments on its Summary Consolidated Balance Sheet for which inventory had not yet been received. During the second quarter of 2015 CryoLife notified Hancock Jaffe that it was in breach of the HJ Agreement due to, among other things, Hancock Jaffe s failure to timely ship inventory. CryoLife believes Hancock Jaffe remains in breach of the HJ Agreement. CryoLife is currently negotiating with Hancock Jaffe an amendment to the HJ Agreement to, among other things, help ensure a continuing supply of product. If CryoLife is unable to secure full satisfaction or repayment of the amounts owed, the prepayment may become impaired in future periods.

PhotoFix Distribution Agreement

In 2014 CryoLife entered into an exclusive supply and distribution agreement with Genesee Biomedical, Inc. (GBI) to acquire the distribution rights to PhotoFix ™, a bovine pericardial patch stabilized using a dye-mediated photo-fixation process that requires no glutaraldehyde. PhotoFix has received FDA 510(k) clearance and is indicated for use in intracardiac repair, including ventricular repair and atrial repair, great vessel repair and suture line buttressing, and pericardial closure.

The agreement between CryoLife and GBI (the GBI Agreement) has an initial five-year term and is renewable for two one-year periods at CryoLife s option. Under the terms of the GBI Agreement, CryoLife is purchasing PhotoFix inventory for resale at an agreed upon transfer price and has the option, which became effective in March 2015, to acquire the PhotoFix product line from GBI. In January 2015 the Company received its initial shipments and launched its distribution of PhotoFix.

5. Hemosphere Acquisition

Overview

On May 16, 2012 CryoLife acquired Hemosphere, Inc. (Hemosphere) and its HeRO Graft product line, which the Company operated as a wholly owned subsidiary until December 31, 2014 when it was merged into the CryoLife, Inc. parent entity. The HeRO Graft is a proprietary graft-based solution for ESRD hemodialysis patients with limited access options and central venous obstruction.

Contingent Consideration

As of the Hemosphere acquisition date, CryoLife recorded a contingent consideration liability of $1.8 million in long-term liabilities on its Summary Consolidated Balance Sheet, representing the estimated fair value of the contingent consideration expected to be paid to the former shareholders of Hemosphere upon the achievement of certain revenue-based milestones. The acquisition agreement provides for a maximum of $4.5 million in future consideration payments through December 2015 based on the attainment of specified sales targets.

The fair value of the contingent consideration liability was estimated by discounting to present value the contingent payments expected to be made based on a probability-weighted scenario approach. The Company applied a risk-based estimate of the probability of achieving each scenario and then applied a cost-of-debt-based discount rate. This fair value measurement was based on unobservable inputs, including management estimates and assumptions about future revenues, and was, therefore, classified as Level 3 within the fair value hierarchy. The Company remeasured this liability at each reporting date and recorded changes in the fair value of the contingent consideration in other (income) expense on the Company s Consolidated Statements of Operations and Comprehensive Income. Increases or decreases in the fair value of the contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing and amount of Company revenue estimates. As of December 31, 2014 the Company reviewed the full year revenue performance of the HeRO Graft for 2014 and 2013, and reviewed its 2015 annual budgets, which were updated in the fourth quarter of 2014. As a result of this review, as of December 31, 2014 the Company believed that achievement of the minimum revenue target to trigger payment was remote, and, therefore, estimated the fair value of the contingent consideration to be zero.

The Company recorded a gain of zero in both the three and nine months ended September 30, 2015 and gains of $196,000 and $492,000 in the three and nine months ended September 30, 2014, respectively, on the remeasurement of the contingent consideration liability. The gains recorded in the prior year periods were due to changes in the Company s estimates, partially offset by the effect of the passage of time on the fair value measurements. The balance of the contingent consideration liability was zero as of September 30, 2015 and December 31, 2014.

6. ValveXchange

Preferred Stock Investment

In July 2011 the Company purchased shares of series A preferred stock of ValveXchange, Inc. (ValveXchange) for approximately $3.5 million. ValveXchange was a private medical device company that was spun off from Cleveland Clinic to develop a lifetime heart valve replacement technology platform featuring exchangeable bioprosthetic

leaflets. As ValveXchange s stock was not actively traded on any public stock exchange, and as the Company s investment was in preferred stock, the Company initially accounted for this investment using the cost method as a long-term asset, investment in equity securities, on the Company s Summary Consolidated Balance Sheet.

During the fourth quarter of 2013 the Company reevaluated its investment in ValveXchange preferred stock for impairment. Based on this analysis, the Company believed that its investment in ValveXchange was fully impaired as of December 31, 2013, and the impairment was other than temporary. As of September 30, 2015 and December 31, 2014 the carrying value of the Company s investment in ValveXchange preferred stock was zero.

Loan Agreement

In July 2011 the Company entered into an agreement with ValveXchange, as amended, to make available to ValveXchange up to $2.0 million in debt financing through a revolving credit facility (the Loan). The Loan included various affirmative and negative covenants, including financial covenant requirements, and would have expired on July 30, 2018, unless terminated earlier. Amounts under the Loan earned interest at an 8% annual rate and were secured by substantially all of the tangible and intangible assets of ValveXchange. The Company advanced $2.0 million to ValveXchange under this loan in 2012.

During the quarter ended December 31, 2014 CryoLife became aware of various factors, including ValveXchange s inability to secure additional funding, its lack of capital to continue basic operations, and the likelihood of impending default on the Loan. In December 2014 CryoLife notified ValveXchange that it was in breach of the Loan, and in January 2015, after ValveXchange failed to cure this breach, CryoLife accelerated the amounts due under the Loan. In January 2015 ValveXchange informed CryoLife management of its intent to file for bankruptcy, which created substantial uncertainty regarding the disposition of CryoLife s claim for amounts it is owed under the Loan. Given these circumstances, CryoLife believed that its Loan became fully impaired in the fourth quarter of 2014. As a result, during the three months ended December 31, 2014 the Company recorded other non-operating expense of $2.0 million to write-down its long-term note receivable from ValveXchange. ValveXchange was dissolved in June 2015. The net carrying value of the long-term note receivable was zero as of September 30, 2015 and December 31, 2014.

7. Medafor Matters

Investment in Medafor Common Stock

In 2009 and 2010 CryoLife purchased shares of common stock in Medafor, Inc., a developer and supplier of plant based hemostatic agents (Medafor). The Company initially recorded its investment using the cost method as a long-term asset, investment in equity securities, on the Company s Summary Consolidated Balance Sheets.

On October 1, 2013 C.R. Bard, Inc., a developer, manufacturer, and marketer of medical technologies in the fields of vascular, urology, oncology, and surgical specialty products (Bard), and its subsidiaries completed its acquisition of all outstanding shares of Medafor common stock. The Company received an initial payment of approximately $15.4 million in the fourth quarter of 2013 for its 2.4 million shares of Medafor common stock and received additional payments of $530,000 in the fourth quarter of 2014 and $891,000 in April 2015 related to the release of transaction consideration in escrow. Based on information provided by Medafor in its September 24, 2013 Proxy Statement, Bard was required to make additional contingent milestone payments based on the achievement of certain net revenue targets measurable through June 2015.

In September 2015 the Company received a letter from the representative of the former shareholders of Medafor, which stated that net sales were insufficient to trigger payment of additional contingent consideration by Bard. The final release of transaction consideration from escrow is expected to be received in October 2017 and is expected to be nominal. This subsequent payment will be recorded as an additional gain if, and when, received by the Company.

The Company recorded a gain on the sale of Medafor investment of zero and $891,000 for the three and nine months ended September 30, 2015, respectively, and zero for both the three and nine months ended September 30, 2014.

Legal Action

In April 2014 CryoLife filed a declaratory judgment lawsuit against Bard, and its subsidiaries Davol, Inc. (Davol) and Medafor (collectively, Defendants), in the U.S. District Court for the District of Delaware (the District Court). CryoLife requested that the District Court declare that CryoLife s manufacture, use, offer for sale, and sale of PerClot

in the U.S. does not, and would not, infringe Bard s U.S. Patent No. 6,060,461 (the 461 Patent). In addition, CryoLife requested that the District Court declare that the claims of the 461 Patent are invalid. CryoLife also requested injunctive relief and an award of attorneys fees.

The lawsuit against the Defendants followed the receipt by CryoLife of a letter from Medafor in September 2012 stating that PerClot, when introduced in the U.S., would infringe the 461 Patent when used in accordance with the method published in CryoLife s literature and with the instructions for use. CryoLife received FDA 510(k) clearance for the sale of PerClot Topical in April 2014 and began distributing PerClot Topical in August 2014. CryoLife also received IDE approval in March 2014 to begin clinical trials for PerClot in certain surgical indications.

In August 2014 Medafor filed a counterclaim against CryoLife for infringement of the 461 Patent. In September 2014 Medafor filed a motion for a preliminary injunction, asking the District Court to enjoin CryoLife s marketing and sale of PerClot in the U.S. In March 2015 the District Court ruled that CryoLife s declaratory judgment lawsuit against Medafor may proceed but dismissed Bard and Davol from the lawsuit. The District Court also granted Medafor s motion for a preliminary injunction, which prohibits CryoLife from marketing, selling, and distributing PerClot in the U.S. while the litigation proceeds. In March 2015 CryoLife ceased all marketing, sales, and distribution of PerClot in the U.S., including PerClot Topical, in accordance with the District Court s order. In April 2015 CryoLife appealed the District Court s ruling on the preliminary injunction motion to the U.S. Court of Appeals for the Federal Circuit. CryoLife dismissed this appeal in June 2015. The case is proceeding through the discovery phase in the District Court.

8. Inventories and Deferred Preservation Costs

Inventories at September 30, 2015 and December 31, 2014 are comprised of the following (in thousands):

	September 30, 2015	December 31, 2014
Raw materials and supplies	$ 7,671	$ 7,942
Work-in-process	985	1,006
Finished goods	5,776	3,791
Total inventories	$ 14,432	$ 12,739

Deferred preservation costs at September 30, 2015 and December 31, 2014 are comprised of the following (in thousands):

	September 30, 2015	December 31, 2014
Cardiac tissues	$ 10,729	$ 10,875
Vascular tissues	12,751	14,321
Total deferred preservation costs	$ 23,480	$ 25,196

9. Goodwill and Other Intangible Assets

Indefinite Lived Intangible Assets

As of September 30, 2015 and December 31, 2014 the carrying values of the Company s indefinite lived intangible assets are as follows (in thousands):

	September 30, 2015	December 31, 2014

Goodwill	$ 11,365	$ 11,365
Procurement contracts and agreements	2,013	2,013
Trademarks	858	853

Based on its experience with similar agreements, the Company believes that its acquired procurement contracts and agreements have indefinite useful lives, as the Company expects to continue to renew these contracts for the foreseeable future. The Company believes that its trademarks have indefinite useful lives as the Company currently anticipates that these trademarks will contribute to cash flows of the Company indefinitely.

As of September 30, 2015 and December 31, 2014 the Company s entire goodwill balance is related to its Medical Devices segment, and there has been no change from the balance recorded as of December 31, 2014.

Definite Lived Intangible Assets

As of September 30, 2015 and December 31, 2014 the gross carrying values, accumulated amortization, and approximate amortization period of the Company s definite lived intangible assets are as follows (in thousands):

September 30, 2015	Gross Carrying Value	Accumulated Amortization	Amortization Period
Acquired technology	$ 14,020	$ 4,669	11 16 Years
Patents	4,047	2,601	17 Years
Distribution and manufacturing rights and know-how	4,059	1,173	11 15 Years
Customer lists and relationships	3,370	994	13 17 Years
Non-compete agreement	381	333	10 Years
Other	268	87	3 5 Years

December 31, 2014	Gross Carrying Value	Accumulated Amortization	Amortization Period
Acquired technology	$ 14,020	$ 3,815	11 16 Years
Patents	4,281	2,497	17 Years
Distribution and manufacturing rights and know-how	4,559	989	11 15 Years
Customer lists and relationships	3,370	813	13 17 Years
Non-compete agreement	381	305	10 Years
Other	461	239	1 5 Years

Amortization Expense

The following is a summary of amortization expense as recorded in general, administrative, and marketing expenses on the Company s Summary Consolidated Statement of Operations and Comprehensive Income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Amortization expense	$ 503	$ 504	$ 1,520	$ 1,503

As of September 30, 2015 scheduled amortization of intangible assets for the next five years is as follows (in thousands):

	Remainder of 2015	2016	2017	2018	2019	2020
Amortization expense	$ 502	$ 2,003	$ 1,950	$ 1,942	$ 1,896	$ 1,722

10. Income Taxes

Income Tax Expense

The Company s effective income tax rate was approximately 25% and -9% for the three and nine months ended September 30, 2015, respectively, as compared to 21% and 22% for the three and nine months ended September 30, 2014, respectively.

The Company s income tax rate for both the three and nine months ended September 30, 2015 was favorably affected by the reversal of $794,000 in uncertain tax positions, primarily related to research and development tax credits for which the statute of limitations has expired. This was partially offset by the unfavorable effect of the absence of the domestic production activities deduction, as the Company does not anticipate being eligible for this deduction in 2015. The Company expects that its effective income tax rate in the fourth quarter of 2015 will be higher than that of the third quarter of 2015, as the anticipated reversal of uncertain tax positions in the fourth quarter is expected to be significantly smaller than in the third quarter.

In June 2014 the Internal Revenue Service completed a limited scope examination of certain of the Company s federal income tax returns. At the resolution of this examination, the Company reevaluated its liabilities for uncertain tax positions, primarily related to its research and development tax credits and credit carryforwards, and, based on revised estimates and the settlement of the

examination, reversed $748,000 in uncertain tax liabilities and tax expense. The Company s income tax rate for the three and nine months ended September 30, 2014 was favorably affected by the reduction of uncertain tax positions and by favorable deductions taken on the Company s 2013 federal tax return, which was filed in the third quarter of 2014.

The Company s income tax rates for the nine months ended September 30, 2015 and 2014 did not include an anticipated benefit from the research and development tax credit, which had not yet been enacted within the respective time periods.

Deferred Income Taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and tax return purposes. The Company generates deferred tax assets primarily as a result of book write-downs, reserves, or impairments which are not immediately deductible for tax return purposes. The Company acquired significant deferred tax assets, primarily net operating loss carryforwards, from its acquisitions of Hemosphere and Cardiogenesis Corporation in the second quarters of 2012 and 2011, respectively. The Company currently estimates that a portion of its state net operating loss carryforwards will not be recoverable and has, therefore, recorded a valuation allowance against these state net operating loss carryforwards.

As of September 30, 2015 the Company maintained a total of $2.1 million in valuation allowances against deferred tax assets, related to state net operating loss carryforwards, and a net deferred tax asset of $19.9 million. As of December 31, 2014 the Company had a total of $2.1 million in valuation allowances against deferred tax assets and a net deferred tax asset of $21.9 million.

11. Debt

GE Credit Agreement

On September 26, 2014 CryoLife amended and restated its credit agreement with GE Capital, extending the expiration date and amending other terms, which are discussed further below. CryoLife s amended and restated credit agreement with GE Capital (the GE Credit Agreement) provides revolving credit for working capital, permitted acquisitions, and general corporate purposes. The GE Credit Agreement has aggregate commitments of $20.0 million for revolving loans, including swing loans subject to a sublimit, and letters of credit, and expires on September 26, 2019. The commitments may be reduced from time to time pursuant to the terms of the GE Credit Agreement. The GE Credit Agreement also permits CryoLife to request a term loan in an aggregate amount of up to $25.0 million to finance the purchase price of a permitted acquisition.

Amounts borrowed under the GE Credit Agreement are secured by substantially all of the tangible and intangible assets of CryoLife and its subsidiaries and bear interest, based on the Company s election, at either LIBOR or GE Capital s base rate plus the respective applicable margins. All swing loans will, however, bear interest at the base loan rate. Commitment fees are paid based on the unused portion of the facility. If an event of default occurs, the applicable interest rate will increase by 2.0% per annum. As of September 30, 2015 and December 31, 2014 the aggregate interest rate was 4.75%. As of September 30, 2015 and December 31, 2014 the outstanding balance of the GE Credit Agreement was zero, and the remaining availability was $20.0 million.

The GE Credit Agreement places limitations on the amount that the Company may borrow and includes various affirmative and negative covenants, including financial covenants such as a requirement that CryoLife (i) not exceed a defined leverage ratio and (ii) maintain minimum earnings subject to defined adjustments as of specified dates. The agreement also (i) limits the payment of cash dividends, up to specified maximums and subject to satisfaction of specified conditions, (ii) requires that, after giving effect to a stock repurchase, the Company maintain liquidity, as

defined within the agreement, of at least $20.0 million, (iii) limits acquisitions or mergers except for certain permitted acquisitions, (iv) sets specified limits on the amount the Company can pay to purchase or redeem CryoLife common stock pursuant to a stock repurchase program and to fund estimated tax liabilities incurred by officers, directors, and employees as a result of awards of stock or stock equivalents, and (v) includes customary conditions on incurring new indebtedness. As of September 30, 2015 the Company was in compliance with the covenants of the GE Credit Agreement.

As required under the terms of the GE Credit Agreement, the Company is maintaining cash and cash equivalents of at least $5.0 million in accounts in which GE Capital has a first priority perfected lien. These amounts are recorded as long-term restricted cash as of September 30, 2015 and December 31, 2014 on the Company s Summary Consolidated Balance Sheets, as they are restricted for the term of the GE Credit Agreement.

Interest Expense

Interest expense was a favorable $78,000 and $18,000 for the three and nine months ended September 30, 2015, respectively, due to the reversal of interest on uncertain tax positions as discussed in Note 10 above. Interest expense was $65,000 and $110,000 for the three and nine months ended September 30, 2014, respectively. Interest expense in all periods included interest on debt and uncertain tax positions.

12. Commitments and Contingencies

Liability Claims

The Company s estimated unreported loss liability was $1.5 million as of September 30, 2015 and $1.4 million as of December 31, 2014. As of September 30, 2015 and December 31, 2014, the related recoverable insurance amounts were $645,000 and $600,000, respectively. The Company accrues its estimate of unreported product and tissue processing liability claims as a component of other long-term liabilities and records the related recoverable insurance amount as a component of other long-term assets, as appropriate. Further analysis indicated that the liability as of September 30, 2015 could have been estimated to be as high as $2.8 million, after including a reasonable margin for statistical fluctuations calculated based on actuarial simulation techniques.

Employment Agreements

In July 2014 the Company s Board of Directors appointed Mr. J. Patrick Mackin as President and Chief Executive Officer (CEO), and the Company and Mr. Mackin entered into an employment agreement, which became effective September 2, 2014. The employment agreement has an initial three-year term. Beginning on the second anniversary of the effective date, and subject to earlier termination pursuant to the agreement, the employment term will, on a daily basis, automatically extend by one day. In accordance with the agreement, on September 2, 2014, Mr. Mackin received a one-time signing bonus of $200,000, a grant of an option to purchase 400,000 shares of the Company s common stock, and a performance stock award grant of 250,000 shares. The agreement also provides for a severance payment, which would become payable upon the occurrence of certain employment termination events, including termination by the Company without cause.

The employment agreement of the Company s former President, CEO, and Executive Chairman, Mr. Steven G. Anderson, conferred certain benefits on Mr. Anderson upon his retirement or termination of employment in conjunction with certain change in control events. As of December 31, 2014 the Company had $2.2 million included in its accrued expenses and other current liabilities on the Summary Consolidated Balance Sheet, primarily related to severance payable upon Mr. Anderson s voluntary retirement. Mr. Anderson s employment agreement took effect on January 1, 2013 and would have terminated on December 31, 2016.

On April 9, 2015 Mr. Anderson retired from service as an employee of the Company and Chair of its Board of Directors, and entered into a Separation Agreement (the Agreement) with the Company. In accordance with the Agreement, in addition to the severance benefit discussed above, Mr. Anderson will receive an additional $400,000 in cash; 25% of the annual bonus he would have been entitled to under his employment agreement, estimated at target payout rates to be approximately $100,000; reimbursement of a Medicare supplement policy for Mr. Anderson and his spouse for the duration of their lives; accelerated vesting of all outstanding and unvested stock options and awards; and reimbursement of attorneys fees not to exceed $20,000. The Company recorded expense of approximately $1.4 million related to the Agreement in the second quarter of 2015. The acceleration of Mr. Anderson s stock options and awards was effective as of the date of his retirement. As of September 30, 2015 the Company had $2.7 million, primarily in accrued compensation, on the Summary Consolidated Balance Sheet, representing severance and cash payments of which $2.4 million was paid in October 2015, six months after Mr. Anderson s retirement. The annual bonus payment is expected to be made in February 2016 at the same time as annual bonus payments, if any, are made

to the Company s officers.

PerClot Technology

On September 28, 2010 the Company entered into a worldwide distribution agreement (the Distribution Agreement) and a license and manufacturing agreement (the License Agreement) with Starch Medical, Inc. (SMI), for PerClot, a polysaccharide hemostatic agent used in surgery. The Distribution Agreement contains certain minimum purchase requirements and has a term of 15 years. Following U.S. regulatory approval and the start of U.S. manufacturing, CryoLife may terminate the Distribution Agreement and the related requirements to purchase minimum amounts of PerClot manufactured by SMI. Upon termination of the Distribution Agreement, CryoLife would manufacture and sell PerClot pursuant to the License Agreement. The Company would pay royalties to SMI at stated rates on net revenues of products manufactured under the License Agreement.

In April 2014 CryoLife received 510(k) clearance from the FDA to market PerClot Topical in the U.S. PerClot Topical is a version of the Company s PerClot product, which was manufactured by the Company at its headquarters and labeled for use in certain topical indications. CryoLife launched PerClot Topical in August 2014. In March 2015 CryoLife ceased all marketing, sales, and distribution of PerClot, including PerClot Topical, in the U.S. in accordance with the District Court s order discussed in Note 7.

The Company is conducting its pivotal clinical trial to gain approval to commercialize PerClot for surgical indications in the U.S. Management believes that the costs of this clinical trial will be significant in 2015 and 2016. The Company began enrollment in the second quarter of 2015 and currently expects to receive PMA from the FDA in 2018. However, if the Company does not prevail or reach a settlement with respect to the patent litigation discussed in Note 7, the timing of the launch of PerClot in the U.S. may be delayed until early 2019, when the 461 Patent expires.

CryoLife paid $500,000 to SMI in January 2015 related to the achievement of a contingent milestone. The Company expects to make additional contingent payments to SMI of up to $1.0 million if certain FDA regulatory and other commercial milestones are achieved.

13. Shareholders Equity

Common Stock Repurchase

In February 2013 the Company s Board of Directors authorized the purchase of up to $15.0 million of its common stock through October 31, 2014. During the year ended December 31, 2014 the Company purchased approximately 585,000 shares for an aggregate purchase price of $5.6 million. These shares were recorded, at cost, as treasury stock on the Company s Summary Consolidated Balance Sheets. In the nine months ended September 30, 2015 the Company did not repurchase any common stock under a repurchase program, and no formal repurchase program was in effect during that period.

Cash Dividends

The Company initiated a quarterly cash dividend of $0.025 per share of common stock outstanding in the third quarter of 2012 and increased this dividend to $0.0275 per share in the second quarter of 2013 and $0.03 per share in the second quarter 2014. The Company paid dividend payments of $853,000 and $2.6 million from cash on hand for the three and nine months ended September 30, 2015, respectively, and $842,000 and $2.5 million for the three and nine months ended September 30, 2014, respectively. The dividend payments were recorded as a reduction to retained earnings on the Company s Summary Consolidated Balance Sheets.

14. Stock Compensation

Overview

The Company has stock option and stock incentive plans for employees and non-employee Directors that provide for grants of restricted stock awards (RSAs), performance stock awards (PSAs), restricted stock units (RSUs), performance stock units (PSUs), and options to purchase shares of Company common stock at exercise prices generally equal to the fair values of such stock at the dates of grant. The Company also maintains a shareholder-approved Employee Stock Purchase Plan (the ESPP) for the benefit of its employees. The ESPP allows eligible employees to purchase common stock on a regular basis at the lower of 85% of the market price at the beginning or end of each offering period.

Equity Grants

During the nine months ended September 30, 2015 the Compensation Committee of the Company s Board of Directors (the Committee) authorized awards from approved stock incentive plans of RSUs to certain employees and RSAs and PSUs to certain Company officers, which, assuming that performance under the PSUs were to be achieved at target levels, together totaled 405,000 shares and had an aggregate grant date market value of $4.3 million. The PSUs granted in 2015 represent the right to receive from 60% to 150% of the target number of shares of common stock. The performance component of PSU awards granted in 2015 was based on attaining specified levels of adjusted EBITDA, adjusted inventory levels, and trade accounts receivable days sales outstanding, each as defined in the PSU grant documents, for the 2015 calendar year. The Company currently believes that achievement of the performance component is probable, and it will reevaluate this likelihood on a quarterly basis.

During the nine months ended September 30, 2014 the Committee authorized awards from approved stock incentive plans of RSUs to certain employees and RSAs and PSUs to certain Company officers, which, counting PSUs at target levels, together totaled 655,000 shares of common stock and had an aggregate grant date market value of $6.6 million. The PSUs granted in 2014 represented the right to receive from 50% to 150% of the target number of shares of common stock. The performance component of PSU awards granted in 2014 was based on attaining specified levels of adjusted EBITDA, as defined in the PSU grant documents, for the 2014 calendar year. The PSUs granted in 2014 earned 50% of the target number of shares.

The Committee authorized, from approved stock incentive plans, grants of stock options to purchase a total of 328,000 and 562,000 shares to certain Company officers during the nine months ended September 30, 2015 and 2014, respectively. The exercise prices of the options were equal to the closing stock prices on their respective grant dates.

Employees purchased common stock totaling 78,000 and 111,000 shares in the nine months ended September 30, 2015 and 2014, respectively, through the ESPP.

Stock Compensation Expense

The following weighted-average assumptions were used to determine the fair value of options:

	Three Months Ended		**Nine Months Ended**	
	September 30, 2015		**September 30, 2015**	
	Stock Options	**ESPP Options**	**Stock Options**	**ESPP Options**
Expected life of options	4.75 Years	.50 Years	4.50 Years	.50 Years
Expected stock price volatility	0.45	0.30	0.44	0.34
Dividends	1.24%	1.06%	1.12%	1.06%
Risk-free interest rate	1.49%	0.11%	1.41%	0.12%

	Three Months Ended		**Nine Months Ended**	
	September 30, 2014		**September 30, 2014**	
	Stock Options	**ESPP Options**	**Stock Options**	**ESPP Options**
Expected life of options	4.20 Years	.50 Years	4.21 Years	.50 Years
Expected stock price volatility	0.55	0.38	0.55	0.34
Dividends	1.18%	1.30%	1.16%	0.99%
Risk-free interest rate	1.41%	0.07%	1.34%	0.10%

The following table summarizes total stock compensation expenses prior to the capitalization of amounts into deferred preservation and inventory costs (in thousands):

	Three Months Ended		**Nine Months Ended**	
	September 30,		**September 30,**	
	2015	**2014**	**2015**	**2014**

RSA, PSA, RSU, and PSU expense	$ 343	$ 944	$ 2,833	$ 2,357
Stock option and ESPP option expense	289	219	1,084	590
Total stock compensation expense	$ 632	$ 1,163	$ 3,917	$ 2,947

Included in the total stock compensation expense, as applicable in each period, were expenses related to RSAs, PSAs, RSUs, PSUs, and stock options issued in each respective year, as well as those issued in prior periods that continue to vest during the period, and compensation related to the ESPP. These amounts were recorded as stock compensation expense and were subject to the Company s normal allocation of expenses to inventory costs and deferred preservation costs. The Company capitalized $79,000 and $71,000 in the three months ended September 30, 2015 and 2014, respectively, and $190,000 and $211,000 in the nine months ended September 30, 2015 and 2014, respectively, of the stock compensation expense into its inventory costs and deferred preservation costs.

As of September 30, 2015 the Company had total unrecognized compensation costs of $5.2 million related to RSAs, PSAs, RSUs, and PSUs and $2.1 million related to unvested stock options, before considering the effect of expected forfeitures. As of September 30, 2015 this expense is expected to be recognized over a weighted-average period of 2.1 years for stock options, 1.9 years for PSAs, 1.9 years for RSUs, 1.4 years for RSAs, and 1.0 years for PSUs.

15. Income Per Common Share

The following table sets forth the computation of basic and diluted income per common share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Basic income per common share	**2015**	**2014**	**2015**	**2014**
Net income	$ 2,145	$ 2,326	$ 1,369	$ 5,546
Net income allocated to participating securities	(44)	(53)	(31)	(112)
Net income allocated to common shareholders	$ 2,101	$ 2,273	$ 1,338	$ 5,434
Basic weighted-average common shares outstanding	27,823	27,367	27,687	27,414
Basic income per common share	$ 0.08	$ 0.08	$ 0.05	$ 0.20

	Three Months Ended September 30,		Nine Months Ended September 30,	
Diluted income per common share	**2015**	**2014**	**2015**	**2014**
Net income	$ 2,145	$ 2,326	$ 1,369	$ 5,546
Net income allocated to participating securities	(44)	(52)	(32)	(110)
Net income allocated to common shareholders	$ 2,101	$ 2,274	$ 1,337	$ 5,436
Basic weighted-average common shares outstanding	27,823	27,367	27,687	27,414
Effect of dilutive stock options and awards[a]	773	901	800	931
Diluted weighted-average common shares outstanding	28,596	28,268	28,487	28,345