

IDEXX LABORATORIES INC /DE
Form 10-Q
October 24, 2014

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 September 30, 2014

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
(State or other jurisdiction of incorporation
or organization)

01-0393723
(IRS Employer Identification No.)

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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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 |
| 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

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, was 47,682,364 on October 15, 2014.

IDEXX LABORATORIES, INC.

Quarterly Report on Form 10-Q

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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)

| | September 30, 2014 | December 31, 2013 |
|---|--------------------------|----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 292,735 | \$ 279,058 |
| Accounts receivable, net of reserves of \$4,182 in 2014 and \$3,533 in 2013 | 160,467 | 158,038 |
| Inventories | 156,007 | 133,427 |
| Deferred income tax assets | 33,258 | 33,226 |
| Other current assets | 60,154 | 48,957 |
| Total current assets | 702,621 | 652,706 |
| Long-Term Assets: | | |
| Property and equipment, net | 291,701 | 281,214 |
| Goodwill | 176,537 | 180,521 |
| Intangible assets, net | 59,210 | 58,844 |
| Other long-term assets, net | 60,563 | 57,231 |
| Total long-term assets | 588,011 | 577,810 |
| TOTAL ASSETS | \$ 1,290,632 | \$ 1,230,516 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 58,255 | \$ 29,941 |
| Accrued liabilities | 167,449 | 148,919 |
| Line of credit | 375,000 | 277,000 |
| Current portion of long-term debt | - | 1,035 |
| Current portion of deferred revenue | 29,560 | 21,458 |
| Total current liabilities | 630,264 | 478,353 |
| Long-Term Liabilities: | | |
| Deferred income tax liabilities | 27,760 | 33,948 |
| Long-term debt, net of current portion | 350,000 | 150,359 |

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| | | |
|--|-----------|---------|
| Long-term deferred revenue, net of current portion | 21,549 | 18,427 |
| Other long-term liabilities | 31,588 | 31,215 |
| Total long-term liabilities | 430,897 | 233,949 |
| Total liabilities | 1,061,161 | 712,302 |

Commitments and Contingencies (Note 14)

Stockholders' Equity:

| | | |
|---|---------------------|---------------------|
| Common stock, \$0.10 par value per share: Authorized: 120,000 shares; Issued: 101,704 and 101,188 shares in 2014 and 2013, respectively | 10,170 | 10,119 |
| Additional paid-in capital | 866,213 | 825,320 |
| Deferred stock units: Outstanding: 123 and 122 units in 2014 and 2013, respectively | 5,253 | 5,110 |
| Retained earnings | 1,649,337 | 1,493,393 |
| Accumulated other comprehensive income | 1,990 | 13,622 |
| Treasury stock, at cost: 53,436 and 49,649 shares in 2014 and 2013, respectively | (2,303,575) | (1,829,378) |
| Total IDEXX Laboratories, Inc. stockholders' equity | 229,388 | 518,186 |
| Noncontrolling interest | 83 | 28 |
| Total stockholders' equity | 229,471 | 518,214 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 1,290,632 | \$ 1,230,516 |

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|--|------------|---|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue: | | | | |
| Product revenue | \$ 233,666 | \$ 206,693 | \$ 690,573 | \$ 629,782 |
| Service revenue | 149,857 | 131,604 | 443,275 | 393,203 |
| Total revenue | 383,523 | 338,297 | 1,133,848 | 1,022,985 |
| Cost of Revenue: | | | | |
| Cost of product revenue | 84,784 | 76,521 | 249,782 | 230,514 |
| Cost of service revenue | 85,403 | 75,993 | 250,115 | 225,018 |
| Total cost of revenue | 170,187 | 152,514 | 499,897 | 455,532 |
| Gross profit | 213,336 | 185,783 | 633,951 | 567,453 |
| Expenses: | | | | |
| Sales and marketing | 70,602 | 60,079 | 206,470 | 179,641 |
| General and administrative | 45,698 | 38,651 | 128,633 | 116,871 |
| Research and development | 24,847 | 21,568 | 73,394 | 65,507 |
| Income from operations | 72,189 | 65,485 | 225,454 | 205,434 |
| Interest expense | (4,294) | (1,463) | (10,033) | (3,477) |
| Interest income | 313 | 456 | 1,272 | 1,345 |
| Income before provision for income taxes | 68,208 | 64,478 | 216,693 | 203,302 |
| Provision for income taxes | 16,045 | 18,786 | 60,693 | 58,745 |
| Net income | 52,163 | 45,692 | 156,000 | 144,557 |
| Less: Net income attributable to noncontrolling interest | 21 | 4 | 55 | 15 |
| Net income attributable to IDEXX Laboratories, Inc. stockholders | \$ 52,142 | \$ 45,688 | \$ 155,945 | \$ 144,542 |
| Earnings per Share: | | | | |
| Basic | \$ 1.05 | \$ 0.87 | \$ 3.07 | \$ 2.70 |
| Diluted | \$ 1.03 | \$ 0.86 | \$ 3.03 | \$ 2.66 |
| Weighted Average Shares Outstanding: | | | | |
| Basic | 49,745 | 52,450 | 50,821 | 53,562 |
| Diluted | 50,400 | 53,242 | 51,522 | 54,391 |

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|--|-----------|---|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$ 52,163 | \$ 45,692 | \$ 156,000 | \$ 144,557 |
| Other comprehensive income, net of tax: | | | | |
| Foreign currency translation adjustments | (19,003) | 9,418 | (15,524) | (2,115) |
| Unrealized (loss) gain on investments, net of tax (benefit) expense of (\$23) and (\$19) in 2014 and \$51 and \$84 in 2013 | (37) | 86 | (32) | 142 |
| Unrealized gain (loss) on derivative instruments: | | | | |
| Unrealized gain (loss), net of tax expense (benefit) of \$2,809 and \$1,796 in 2014 and (\$1,512) and \$1,278 in 2013 | 6,204 | (3,601) | 4,027 | 3,066 |
| Less: reclassification adjustment for gains included in net income, net of tax expense (benefit) of \$67 and (\$24) in 2014 and \$329 and \$542 in 2013 | (205) | (834) | (103) | (1,485) |
| Unrealized gain (loss) on derivative instruments | 5,999 | (4,435) | 3,924 | 1,581 |
| Other comprehensive (loss) income, net of tax | (13,041) | 5,069 | (11,632) | (392) |
| Comprehensive income | 39,122 | 50,761 | 144,368 | 144,165 |
| Less: comprehensive income attributable to noncontrolling interest | 21 | 4 | 55 | 15 |
| Comprehensive income attributable to IDEXX Laboratories, Inc. | \$ 39,101 | \$ 50,757 | \$ 144,313 | \$ 144,150 |

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

IDEXX LABORATORIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

| | For the Nine Months Ended September 30, | |
|---|---|------------|
| | 2014 | 2013 |
| Cash Flows from Operating Activities: | | |
| Net income | \$ 156,000 | \$ 144,557 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 43,610 | 41,130 |
| Provision for uncollectible accounts | 1,678 | 1,226 |
| Benefit of deferred income taxes | (6,729) | (984) |
| Share-based compensation expense | 13,463 | 12,265 |
| Other | (79) | 446 |
| Tax benefit from share-based compensation arrangements | (9,581) | (7,438) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (8,464) | (12,795) |
| Inventories | (12,638) | (10,216) |
| Other assets | (3,375) | 4,717 |
| Accounts payable | 6,876 | 3,958 |
| Accrued liabilities | 16,216 | (335) |
| Deferred revenue | 11,566 | 4,050 |
| Net cash provided by operating activities | 208,543 | 180,581 |
| Cash Flows from Investing Activities: | | |
| Purchases of property and equipment | (42,504) | (61,459) |
| Proceeds from disposition of pharmaceutical product lines | - | 3,500 |
| Proceeds from sale of equity investment | 5,400 | - |
| Acquisitions of a business, net of cash acquired | (7,516) | (10,101) |
| Acquisitions of intangible assets | (175) | (1,024) |
| Net cash used by investing activities | (44,795) | (69,084) |
| Cash Flows from Financing Activities: | | |
| Borrowings on revolving credit facilities, net | 98,000 | 185,200 |
| Issuance of long-term debt | 200,000 | - |
| Debt issue costs | (1,357) | - |
| Payment of notes payable | (1,394) | (858) |
| Repurchases of common stock | (468,968) | (282,910) |
| Proceeds from exercises of stock options and employee stock purchase plans | 18,361 | 21,734 |
| Tax benefit from share-based compensation arrangements | 9,581 | 7,438 |

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| | | |
|--|------------|------------|
| Net cash used by financing activities | (145,777) | (69,396) |
| Net effect of changes in exchange rates on cash | (4,294) | (1,276) |
| Net increase in cash and cash equivalents | 13,677 | 40,825 |
| Cash and cash equivalents at beginning of period | 279,058 | 223,986 |
| Cash and cash equivalents at end of period | \$ 292,735 | \$ 264,811 |

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

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements of IDEXX Laboratories, Inc. and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (“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 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 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, 2013 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for the full year or any future period. These condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 and our Annual Report on Form 10-K for the year ended December 31, 2013 (the “2013 Annual Report”) filed with the Securities and Exchange Commission.

Reclassifications and Revisions

Certain prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no material impact on previously reported results of operations, financial position or cash flows.

Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect non-cash investing activities impacting accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. These revisions increased the operating cash flows related to the change in accounts payable, accrued liabilities and inventory for the nine months ended September 30, 2013 by \$0.9 million from the amounts previously reported, and decreased investing cash flows related to purchases of property and equipment by the same amount. The revisions to the condensed consolidated statements of cash flows noted above represent an error that is not deemed to be material, individually or in the aggregate, to the prior period condensed consolidated financial statements.

Note 2. ACCOUNTING POLICIES

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2013 Annual Report.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an amendment which will replace most of the existing revenue recognition guidance within U.S. GAAP. The core principle of this guidance is that an entity should recognize revenue for the transfer of goods or services to customers in an amount that it expects to be entitled to receive for those goods or services. In doing so, companies will be required to make certain judgments and estimates, including identifying contract performance obligations, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price among separate performance obligations. Additionally, the amendment requires disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, significant judgments reached in the application of the guidance and assets recognized from the costs to obtain or fulfill a contract. Effective for the Company beginning on January 1, 2017, the amendment allows for two methods of adoption, a full retrospective method or a modified

retrospective approach with the cumulative effect recognized at the date of initial application. Early adoption is not permitted. We are in the process of determining the method of adoption and the impact of this amendment on our consolidated financial statements.

In August 2014, the FASB issued an amendment that requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. The amendments in this update provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for one year after the date that the financial statements are issued and to provide related footnote disclosures. In doing so, the amendments should reduce diversity in the timing and content of footnote disclosures. The amendments in this update apply to all entities and are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This amendment is not expected to have a material impact on our financial statements.

NOTE 3. SHARE-BASED COMPENSATION

The fair value of options, restricted stock units, deferred stock units and employee stock purchase rights awarded during the three and nine months ended September 30, 2014 totaled \$1.0 million and \$23.8 million, respectively, as compared to \$0.3 million and \$18.9 million for the three and nine months ended September 30, 2013, respectively.

The total unrecognized compensation expense, net of estimated forfeitures, for unvested share-based compensation awards outstanding at September 30, 2014 was \$41.2 million, which will be recognized over a weighted average period of approximately 1.8 years.

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 Nine Months Ended September 30, | | | |
|---------------------------------|---|---|------|---|
| | 2014 | | 2013 | |
| Expected stock price volatility | 28 | % | 33 | % |
| Expected term, in years | 5.7 | | 4.7 | |
| Risk-free interest rate | 1.5 | % | 0.9 | % |

Weighted average fair value of options granted \$ 36.14 \$ 26.36

1 Options granted after May 8, 2013 have a contractual term of ten years. Options granted between January 1, 2013 and May 8, 2013 have a contractual term of seven years.

note 4. acquisitions and disposition of strategic investment

During the three months ended September 30, 2014, we paid an aggregate of \$3.0 million in cash and recorded contingent consideration of \$0.8 million upon the acquisition of substantially all of the assets of a business that offers a cloud-based software solution that supports veterinary preventive care plans. As part of this business acquisition, we recorded \$3.1 million in amortizable intangible assets and \$0.7 million in goodwill. Amortizable intangible assets primarily consisted of software which was assigned a useful life of 7 years. All assets acquired in connection with this business acquisition were assigned to our Companion Animal Group segment. Pro forma information has not been presented for this business acquisition because such information is not material to the financial statements.

In July 2014, we paid an aggregate of \$3.0 million in cash and recorded contingent consideration of \$1.1 million upon the acquisition of certain assets of a veterinary reference laboratory testing business, including a customer list in the U.S. Amortizable intangible assets primarily consisted of the aforementioned customer list, which was assigned a useful life of 14 years and was assigned to our Companion Animal Group segment. Pro forma information has not been presented for this business acquisition because such information is not material to the financial statements.

In June 2014, we divested our investment in a company that owns and operates veterinary hospitals. Upon the closing date, we received proceeds of \$5.4 million in exchange for two outstanding promissory notes of the company and its subsidiaries and our 11% equity interest in the company. This investment has been accounted for under the equity method of accounting since acquisition in the fourth quarter of 2010. Upon the disposition of this strategic investment, we realized a \$0.7 million gain, which has been reflected as a reduction to general and administrative expense.

Note 5. Inventories

Inventories, which are stated at the lower of cost (first-in, first-out) or market, include material, conversion costs and inbound freight charges. The components of inventories were as follows (in thousands):

| | September 30, 2014 | December 31, 2013 |
|-----------------|--------------------------|-------------------------|
| Raw materials | \$ 26,372 | \$ 23,766 |
| Work-in-process | 16,194 | 14,359 |
| Finished goods | 113,441 | 95,302 |
| | \$ 156,007 | \$ 133,427 |

Note 6. Goodwill and Intangible Assets, NET

The decrease in goodwill during the nine months ended September 30, 2014 resulted primarily from changes in foreign currency exchange rates. The increase in intangible assets other than goodwill during the nine months ended September 30, 2014 resulted primarily from intangibles recognized in connection with the acquisition of businesses, partly offset by the continued amortization of our intangible assets and, to a lesser extent, changes in foreign currency exchange rates. See Note 4 for information regarding amortizable intangible assets recognized in connection with the acquisition of businesses during the nine months ended September 30, 2014.

NOTE 7. Other NONCURRENT ASSETS

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

| | September 30, 2014 | December 31, 2013 |
|---|--------------------------|-------------------------|
| Investment in long-term product supply arrangements | \$ 11,078 | \$ 13,075 |
| Customer acquisition costs, net | 23,742 | 21,199 |
| Other assets | 25,743 | 22,957 |
| | \$ 60,563 | \$ 57,231 |

Note 8. Accrued liabilities

Accrued liabilities consisted of the following (in thousands):

| | September 30, 2014 | December 31, 2013 |
|--|--------------------------|-------------------------|
| Accrued expenses | \$ 47,502 | \$ 44,274 |
| Accrued employee compensation and related expenses | 70,521 | 62,474 |
| Accrued taxes | 17,314 | 16,508 |
| Accrued customer programs | 32,112 | 25,663 |
| | \$ 167,449 | \$ 148,919 |

Note 9. DEBT

In June 2014, we refinanced our existing \$450.0 million unsecured revolving credit facility by entering into an amended and restated credit agreement relating to a five-year unsecured revolving credit facility in the principal amount of \$700 million with a syndicate of multinational banks, which matures on June 18, 2019 (the new credit facility and the previous credit facility are referred to collectively as the “Credit Facility”) and requires no scheduled prepayments before that date. Although the Credit Facility does not mature until June 18, 2019, all amounts borrowed under the terms of the Credit Facility are reflected in the current liabilities section in the accompanying condensed consolidated balance sheets because the Credit Facility contains a subjective material adverse event clause, which allows the debt holders to call the loans under the Credit Facility if we fail to provide prompt written notice to the syndicate of such an event. At September 30, 2014 and December 31, 2013, we had \$375.0 million and \$277.0 million, respectively, outstanding under the Credit Facility with a weighted average effective interest rate of 1.6%. The funds available under the Credit Facility at September 30, 2014 and December 31, 2013 reflect a further reduction due to the issuance of a letter of credit for \$1.0 million, which was issued in connection with our workers’ compensation policy.

Applicable interest rates on borrowings under the Credit Facility generally range from 0.875 to 1.375 percentage points (“Credit Spread”) above the London interbank offered rate or the Canadian Dollar-denominated bankers’ acceptance rate, based on our leverage ratio, or the prevailing prime rate plus a maximum spread of up to 0.375%, based on our leverage ratio. We have entered into forward fixed interest rate swap agreements to manage the economic effect of the first \$80 million of variable interest rate borrowings. As such, we continue to designate the existing interest rate swaps as cash flow hedges. See Note 17 for a discussion of our derivative instruments and hedging activities. Under the Credit Facility, we pay quarterly commitment fees of 0.15% to 0.35%, based on our leverage ratio, on any unused commitment.

The obligations under the Credit Facility may be accelerated upon the occurrence of an event of default under the Credit Facility, which includes customary events of default, including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974, the failure to pay specified indebtedness and a change of control default. The Credit Facility contains affirmative, negative and financial covenants customary for financings of this type. The negative covenants include restrictions on liens, indebtedness of subsidiaries of the Company, fundamental changes, investments, transactions with affiliates and certain restrictive agreements. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, defined as the consolidated leverage ratio under the terms of the Credit Facility, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Credit Facility.

In December 2013, we issued and sold through a private placement an aggregate principal amount of \$150 million of senior notes consisting of \$75 million of 3.94% Series A Senior Notes due December 11, 2023 (the “2023 Notes”) and \$75 million of 4.04% Series B Senior Notes due December 11, 2025 (the “2025 Notes” and together with the 2023 Notes, the “December Notes”) under a Note Purchase Agreement among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (the “December 2013 Note Agreement”).

In July 2014, we issued and sold through a private placement an aggregate principal amount of \$125 million of senior notes consisting of \$75 million of 3.76% Series B Senior Notes due July 21, 2024 (the “2024 Notes”) and \$50 million of 3.32% Series A Senior Notes due July 21, 2021 (the “2021 Notes”) and together with the 2024 Notes, the “Prudential Notes”) under a Note Purchase and Private Shelf Agreement among the Company, Prudential Investment Management, Inc. and the accredited institutional purchasers named therein (the “July 2014 Note Agreement”).

In September 2014, we issued and sold through a private placement an aggregate principal amount of \$75 million of 3.72% Senior Notes due September 4, 2026 (the “2026 Notes”) and together with the Prudential Notes and the December Notes, the “Senior Notes”) under a Note Purchase Agreement dated as of July 22, 2014 among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (such agreement, together with July 2014 Note Agreement and December 2013 Note Agreement, the “Senior Note Agreements”).

The Senior Note Agreements contain affirmative, negative and financial covenants customary for agreements of this type. The negative covenants include restrictions on liens, indebtedness of our subsidiaries, priority indebtedness, fundamental changes, investments, transactions with affiliates, certain restrictive agreements and violations of laws and regulations. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, as defined in the Senior Note Agreements, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Senior Note Agreements.

Should we elect to prepay the Senior Notes, such aggregate prepayment will include the applicable make-whole amount(s), as defined within the applicable Senior Note Agreements. Additionally, in the event of a change in control of the Company or upon the disposition of certain assets of the Company the proceeds of which are not reinvested (as defined in the Senior Note Agreements), we may be required to prepay all or a portion of the Senior Notes. The obligations under the Senior Notes may be accelerated upon the occurrence of an event of default under the applicable Senior Note Agreement, each of which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974 and the failure to pay specified indebtedness.

In June 2014, we paid off the remaining outstanding principal balance on the mortgage related to our worldwide headquarters in Westbrook, Maine.

Note 10. Repurchases of common STOCK

The following is a summary of our open market common stock repurchases for the three and nine months ended September 30, 2014 and 2013 (in thousands, except per share amounts):

| | For the Three Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2014 | |
|----------------------------------|--|-----------|---|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Shares repurchased | 2,197 | 801 | 3,746 | 3,139 |
| Total cost of shares repurchased | \$ 272,342 | \$ 76,575 | \$ 468,968 | \$ 282,910 |
| Average cost per share | \$ 123.98 | \$ 95.52 | \$ 125.18 | \$ 90.12 |

We primarily acquire shares by means of repurchases in the open market. However, we also acquire shares that are surrendered by employees in payment for the minimum required withholding taxes due on the vesting of restricted stock units and the settlement of deferred stock units, otherwise referred to herein as employee surrenders. The number of shares acquired through employee surrenders during both the three months ended September 30, 2014 and 2013 was not material. We acquired 42,742 shares having a total cost of \$5.3 million in connection with such

employee surrenders during the nine months ended September 30, 2014, as compared to 47,483 shares having a total cost of \$4.3 million during the nine months ended September 30, 2013.

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 both the nine months ended September 30, 2014 and 2013 was not material.

Note 11. Income Taxes

Our effective income tax rates were 23.5% and 28.0% for the three and nine months ended September 30, 2014, respectively, as compared to 29.1% and 28.9% for the three and nine months ended September 30, 2013, respectively.

The decrease in our effective income tax rate for the three months ended September 30, 2014, as compared to the same period of the prior year, was related to a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and higher relative earnings subject to international tax rates that are lower than domestic tax rates. These favorable factors were partly offset by the U.S. research and development (“R&D”) tax credit which was not available during the three months ended September 30, 2014 because the legislation expired as of January 1, 2014.

The decrease in our effective income tax rate for the nine months ended September 30, 2014, as compared to the same period of the prior year, was related to higher relative earnings subject to international tax rates that are lower than domestic tax rates, a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and the resolution of domestic and international tax audits, which resulted in a net reduction in our provision for uncertain tax positions. These favorable factors were partly offset by the R&D tax credit, which expired as of January 1, 2014. During the three months ended March 31, 2013, legislation in the U.S. retroactively allowed the R&D tax credit for all of 2012 and extended the R&D tax credit through the year ending December 31, 2013. Because this legislation was enacted during the three months ended March 31, 2013, the full benefit of the credit related to the prior years’ activities was recognized within that quarter.

Note 12. ACCUMULATED OTHER Comprehensive Income

The changes in accumulated other comprehensive income (“AOCI”), net of tax, for the nine months ended September 30, 2014 consisted of the following (in thousands):

| For the Nine Months Ended September 30, 2014 | Unrealized Gain on Investments, Net of Tax | Unrealized (Loss) Gain on Derivative Instruments, Net of Tax | Cumulative Translation Adjustment | Total |
|--|--|--|---|-----------|
| Balance as of December 31, 2013 | \$ 108 | \$ (179) | \$ 13,693 | \$ 13,622 |
| Other comprehensive (loss) income before reclassifications | (32) | 4,027 | (15,524) | (11,529) |
| Gains reclassified from accumulated other comprehensive income | - | (103) | - | (103) |
| Balance as of September 30, 2014 | \$ 76 | \$ 3,745 | \$ (1,831) | \$ 1,990 |

The following is a summary of reclassifications out of AOCI for the three and nine months ended September 30, 2014 and 2013 (in thousands):

| Details about AOCI Components | Affected Line Item in the Statement Where Net Income is Presented | Amounts Reclassified from AOCI For the Three Months Ended September 30, | |
|--|--|--|----------|
| | | 2014 | 2013 |
| Gains (losses) on derivative instruments classified as cash flow hedges included in net income: | | | |
| Foreign currency exchange contracts | Cost of revenue | \$ 540 | \$ 1,294 |
| Interest rate swaps | Interest expense | (268) | (131) |
| | Total gains before tax | 272 | 1,163 |
| | Tax expense | 67 | 329 |
| | Gains, net of tax | \$ 205 | \$ 834 |
| | | | |
| Details about AOCI Components | Affected Line Item in the Statement Where Net Income is Presented | Amounts Reclassified from AOCI For the Nine Months Ended September 30, | |

| | | 2014 | 2013 |
|---|------------------------|--------|----------|
| Gains (losses) on derivative instruments classified as cash flow hedges included in net income: | | | |
| Foreign currency exchange contracts | Cost of revenue | \$ 874 | \$ 2,659 |
| Interest rate swaps | Interest expense | (795) | (632) |
| | Total gains before tax | 79 | 2,027 |
| | Tax (benefit) expense | (24) | 542 |
| | Gains, net of tax | \$ 103 | \$ 1,485 |

Note 13. Earnings per Share

Basic earnings per share is computed by dividing net income attributable to IDEXX Laboratories, Inc. stockholders by the weighted average number of shares of common stock and vested deferred stock units outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased for the assumed exercise of dilutive options and assumed issuance of unvested restricted stock units and unvested deferred stock units using the treasury stock method unless the effect is anti-dilutive. The treasury stock method assumes that proceeds, including cash received from the exercise of employee stock options, the total unrecognized compensation expense for unvested share-based compensation awards and the excess tax benefits resulting from share-based compensation tax deductions in excess of the related expense recognized for financial reporting purposes, would be used to purchase our common stock at the average market price during the period. Vested deferred stock units outstanding are included in shares outstanding for basic and diluted earnings per share because the associated shares of our common stock are issuable for no cash consideration, the number of shares of our common stock to be issued is fixed and issuance is not contingent. See Note 4 to the consolidated financial statements in our 2013 Annual Report for additional information regarding deferred stock units.

The following is a reconciliation of shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2014 and 2013 (in thousands):

| | For the Three Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | |
|--|--|--------|---|--------|
| Shares outstanding for basic earnings per share | 49,745 | 52,450 | 50,821 | 53,562 |
| Shares outstanding for diluted earnings per share: | | | | |
| Shares outstanding for basic earnings per share | 49,745 | 52,450 | 50,821 | 53,562 |
| Dilutive effect of share-based payment awards | 655 | 792 | 701 | 829 |
| | 50,400 | 53,242 | 51,522 | 54,391 |

Certain options to acquire shares have been excluded from the calculation of shares outstanding for diluted earnings per share because they were anti-dilutive. The following table presents information concerning those anti-dilutive options for the three and nine months ended September 30, 2014 and 2013 (in thousands):

| | For the Three Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | |
|--|---|-----|---|-----|
| Weighted average number of shares underlying anti-dilutive options | 365 | 561 | 311 | 530 |

Note 14. Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at September 30, 2014 are consistent with those discussed in Note 14 to the consolidated financial statements in our 2013 Annual Report, with the exception of \$200 million of long-term debt issued during the nine months ended September 30, 2014.

Note 15. Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-maker is our Chief Executive Officer. Our reportable segments include diagnostic and information technology-based products and services for the veterinary market, which we refer to as the Companion Animal Group (“CAG”), water quality products (“Water”) and diagnostic tests for livestock and poultry health and to ensure the quality and safety of milk and food, which we refer to as Livestock, Poultry and Dairy (“LPD”). Our Other operating segment combines and presents products for the human point-of-care medical diagnostics market with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

Items that are not allocated to our operating segments are as follows: a portion of corporate support function and personnel-related expenses; certain manufacturing costs; corporate research and development expenses that do not align with one of our existing business or service categories; the difference between estimated and actual share-based compensation expense; and certain foreign currency exchange gains and losses. These amounts are shown under the caption “Unallocated Amounts.”

We estimate our share-based compensation expense, corporate support function expenses and certain personnel-related costs and allocate the estimated expenses to the operating segments. This allocation differs from actual expense and consequently yields a difference that is reported under the caption “Unallocated Amounts.”

With respect to manufacturing costs, the costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption “Unallocated Amounts.”

Additionally, in certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption “Unallocated Amounts.”

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The following is a summary of segment performance for the three and nine months ended September 30, 2014 and 2013 (in thousands):

| | For the Three Months Ended September 30, | | | | Unallocated Amounts | Consolidated Total |
|---|--|-----------|-----------|----------|------------------------|-----------------------|
| | CAG | Water | LPD | Other | | |
| 2014 | | | | | | |
| Revenue | \$ 320,724 | \$ 25,747 | \$ 29,648 | \$ 7,404 | \$ - | \$ 383,523 |
| Income (loss) from operations | \$ 62,608 | \$ 11,367 | \$ 3,886 | \$ 794 | \$ (6,466) | \$ 72,189 |
| Interest expense, net | | | | | | (3,981) |
| Income before provision for income taxes | | | | | | 68,208 |
| Provision for income taxes | | | | | | 16,045 |
| Net income | | | | | | 52,163 |
| Less: Net income attributable to noncontrolling interest | | | | | | 21 |
| Net income attributable to IDEXX Laboratories, Inc. stockholders | | | | | | \$ 52,142 |
| 2013 | | | | | | |
| Revenue | \$ 283,843 | \$ 23,247 | \$ 25,131 | \$ 6,076 | \$ - | \$ 338,297 |
| Income from operations | \$ 52,711 | \$ 10,414 | \$ 1,125 | \$ 612 | \$ 623 | \$ 65,485 |
| Interest expense, net | | | | | | (1,007) |
| Income before provision for income taxes | | | | | | 64,478 |
| Provision for income taxes | | | | | | 18,786 |
| Net income | | | | | | 45,692 |
| Less: Net income attributable to noncontrolling interest | | | | | | 4 |
| Net income attributable to IDEXX Laboratories, Inc. stockholders | | | | | | \$ 45,688 |

| | For the Nine Months Ended September 30, | | | | Unallocated Amounts | Consolidated Total |
|-------------------------------|---|-----------|-----------|-----------|------------------------|-----------------------|
| | CAG | Water | LPD | Other | | |
| 2014 | | | | | | |
| Revenue | \$ 949,009 | \$ 71,655 | \$ 93,738 | \$ 19,446 | \$ - | \$ 1,133,848 |
| Income (loss) from operations | \$ 188,820 | \$ 29,547 | \$ 17,669 | \$ 1,134 | \$ (11,716) | \$ 225,454 |
| Interest expense, net | | | | | | (8,761) |

| | | | | | | |
|--|------------|-----------|-----------|-----------|------------|--------------|
| Income before provision for income taxes | | | | | | 216,693 |
| Provision for income taxes | | | | | | 60,693 |
| Net income | | | | | | 156,000 |
| Less: Net income attributable to noncontrolling interest | | | | | | 55 |
| Net income attributable to IDEXX Laboratories, Inc. stockholders | | | | | | \$ 155,945 |
| 2013 | | | | | | |
| Revenue | \$ 856,617 | \$ 66,297 | \$ 81,448 | \$ 18,623 | \$ - | \$ 1,022,985 |
| Income (loss) from operations | \$ 167,377 | \$ 28,682 | \$ 9,176 | \$ 1,888 | \$ (1,689) | \$ 205,434 |
| Interest expense, net | | | | | | (2,132) |
| Income before provision for income taxes | | | | | | 203,302 |
| Provision for income taxes | | | | | | 58,745 |
| Net income | | | | | | 144,557 |
| Less: Net income attributable to noncontrolling interest | | | | | | 15 |
| Net income attributable to IDEXX Laboratories, Inc. stockholders | | | | | | \$ 144,542 |

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The following is a summary of revenue by product and service category for the three and nine months ended September 30, 2014 and 2013 (in thousands):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|--|------------|---|--------------|
| | 2014 | 2013 | 2014 | 2013 |
| CAG segment revenue: | | | | |
| CAG Diagnostics recurring revenue: | \$ 277,957 | \$ 242,163 | \$ 818,327 | \$ 734,989 |
| IDEXX VetLab® consumables | 90,971 | 76,080 | 264,405 | 230,637 |
| VetLab service and accessories | 13,716 | 12,749 | 40,332 | 37,312 |
| Rapid assay products | 46,777 | 43,042 | 139,329 | 133,182 |
| Reference laboratory diagnostic and consulting services | 126,493 | 110,292 | 374,261 | 333,858 |
| CAG Diagnostics capital - instruments | 18,040 | 19,115 | 55,508 | 55,702 |
| Customer information management and digital imaging systems | 24,727 | 22,565 | 75,174 | 65,926 |
| CAG segment revenue | 320,724 | 283,843 | 949,009 | 856,617 |
| Water segment revenue | 25,747 | 23,247 | 71,655 | 66,297 |
| LPD segment revenue | 29,648 | 25,131 | 93,738 | 81,448 |
| Other segment revenue | 7,404 | 6,076 | 19,446 | 18,623 |
| Total revenue | \$ 383,523 | \$ 338,297 | \$ 1,133,848 | \$ 1,022,985 |

Note 16. FAIR VALUE MEASUREMENTS

U.S. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. U.S. GAAP requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value.

The Company has certain financial assets and liabilities that are measured at fair value on a recurring basis, certain nonfinancial assets and liabilities that may be measured at fair value on a nonrecurring basis and certain financial assets and liabilities that are not measured at fair value in our condensed consolidated balance sheets but for which we disclose the fair value. The fair value disclosures of these assets and liabilities are based on a three-level hierarchy, which is defined as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. We did not have any transfers between Level 1 and Level 2 or transfers in or out of Level 3 of the fair value hierarchy during the nine months ended September 30, 2014.

Our foreign currency exchange contracts and interest rate swap agreements are measured at fair value on a recurring basis in our accompanying condensed consolidated balance sheets. We measure the fair value of our foreign currency exchange contracts classified as derivative instruments using an income approach, based on prevailing market forward rates less the contract rate multiplied by the notional amount. The product of this calculation is then adjusted for counterparty risk. We measure the fair value of our interest rate swaps classified as derivative instruments using an income approach, utilizing a discounted cash flow analysis based on the terms of the contract and the interest rate curve adjusted for counterparty risk.

The amount outstanding under our Credit Facility, notes receivable and long-term debt are measured at carrying value in our accompanying condensed consolidated balance sheets though we disclose the fair value of these financial instruments. We determine the fair value of the amount outstanding under our Credit Facility, notes receivable and long-term debt using an income approach, utilizing a discounted cash flow analysis based on current market interest rates for debt issues with similar remaining years to maturity, adjusted for applicable credit risk. Our Credit Facility and long-term debt are valued using Level 2 inputs. The estimated fair value of our Credit Facility approximates its carrying value. At September 30, 2014, the estimated fair value and carrying value of our long-term debt were \$361.7 million and \$350.0 million, respectively. As of December 31, 2013, the carrying value of our long-term debt approximated its fair value. During the nine months ended September 30, 2014, we disposed of notes

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receivable representing a strategic investment in a privately held company. As of December 31, 2013, these notes receivable had a carrying value that approximated their fair value of \$5.1 million and were valued using Level 3 inputs. See Note 4 for further information regarding the disposition of the notes receivable during June 2014.

The following tables set forth our assets and liabilities that were measured at fair value on a recurring basis at September 30, 2014 and at December 31, 2013 by level within the fair value hierarchy (in thousands):

| | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Balance at September 30, 2014 |
|--|--|--|---------------------------------------|-------------------------------------|
| As of September 30, 2014 | (Level 1) | (Level 2) | (Level 3) | |
| Assets | | | | |
| Money market funds(1) | \$ 164,740 | \$ - | \$ - | \$ 164,740 |
| Equity mutual funds(2) | 2,671 | - | - | 2,671 |
| Foreign currency exchange contracts(3) | - | 7,292 | - | 7,292 |
| Liabilities | | | | |
| Foreign currency exchange contracts(3) | - | 1,091 | - | 1,091 |
| Deferred compensation(4) | 2,671 | - | - | 2,671 |
| Interest rate swaps(5) | - | 1,242 | - | 1,242 |

| | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Balance at December 31, 2013 |
|--|--|--|---------------------------------------|------------------------------------|
| As of December 31, 2013 | (Level 1) | (Level 2) | (Level 3) | |
| Assets | | | | |
| Money market funds(1) | \$ 153,109 | \$ - | \$ - | \$ 153,109 |
| Equity mutual funds(2) | 2,847 | - | - | 2,847 |
| Foreign currency exchange contracts(3) | - | 4,044 | - | 4,044 |

Liabilities

| | | | | |
|--|-------|-------|---|-------|
| Foreign currency exchange contracts(3) | - | 3,096 | - | 3,096 |
| Deferred compensation(4) | 2,847 | - | - | 2,847 |
| Interest rate swaps(5) | - | 1,821 | - | 1,821 |

- (1) Money market funds are included within cash and cash equivalents. The remaining balance of cash and cash equivalents as of September 30, 2014 and December 31, 2013 consisted of demand deposits.
- (2) Equity mutual funds relate to a deferred compensation plan that was assumed as part of a previous business combination. This amount is included within other long-term assets, net. See number (4) below for a discussion of the related deferred compensation liability.
- (3) Foreign currency exchange contracts are included within other current assets; other long-term assets, net; accrued liabilities; or other long-term liabilities depending on the gain (loss) position and anticipated settlement date.
- (4) A deferred compensation plan assumed as part of a previous business combination is included within other long-term liabilities. The fair value of our deferred compensation plan is indexed to the performance of the underlying equity mutual funds discussed in number (2) above.
- (5) Interest rate swaps are included within accrued liabilities.

The estimated fair value of certain financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate carrying value due to their short maturity.

Note 17. Derivative Instruments and Hedging

Disclosure within this footnote is presented to provide transparency about how and why we use derivative instruments, how the instruments and related hedged items are accounted for, and how the instruments and related hedged items affect our financial position, results of operations and cash flows.

We are exposed to certain risks related to our ongoing business operations. The primary risks that we manage by using derivative instruments are foreign currency exchange risk and interest rate risk. Our subsidiaries enter into foreign currency exchange contracts to manage the exchange risk associated with their forecasted intercompany inventory purchases and sales for the next year. From time to time, we may also enter into foreign currency exchange contracts to minimize the impact of foreign currency fluctuations associated with specific, significant transactions. We enter into interest rate swaps to minimize the impact of interest rate fluctuations associated with our variable-rate Credit Facility.

The primary purpose of our foreign currency hedging activities is to protect against the volatility associated with foreign currency transactions, including transactions denominated in euro, British pound, Japanese yen, Canadian dollar, Australian dollar and Swiss franc. We also utilize natural hedges to mitigate our transaction and commitment exposures. Our corporate policy prescribes the range of allowable hedging activity. We enter into foreign currency exchange contracts with large multinational financial institutions and we do not hold or engage in transactions involving derivative instruments for purposes other than risk management.

We recognize all derivative instruments, including our foreign currency exchange contracts and interest rate swap agreements, on the balance sheet at fair value at the balance sheet date. Derivative instruments that do not qualify for hedge accounting treatment must be recorded at fair value through earnings. To qualify for hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. If a derivative instrument qualifies for hedge accounting, changes in the fair value of the derivative instrument from the effective portion of the hedge are deferred in AOCI, net of tax, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. We immediately record in earnings the extent to which a hedge instrument is not effective in achieving offsetting changes in fair value. We de-designate derivative instruments from hedge accounting when the likelihood of the hedged transaction occurring becomes less than probable. For de-designated instruments, the gain or loss from the time of de-designation through maturity of the instrument is recognized in earnings. Any gain or loss in AOCI at the time of de-designation is reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. See Note 12 for further information regarding the effect of derivative instruments designated as cash flow hedges on the condensed consolidated statements of operations for the three and nine months ended September 30, 2014 and 2013.

We enter into master netting arrangements with the counterparties to our derivative transactions which permit outstanding receivables and payables to be offset in the event of default. Our derivative contracts do not require either party to post cash collateral. We elect to present our derivative assets and liabilities in the accompanying condensed consolidated balance sheets on a gross basis. All cash flows related to our foreign currency exchange contracts and interest rate swaps are classified as operating cash flows, which is consistent with the cash flow treatment of the underlying items being hedged.

Cash Flow Hedges

We have designated our foreign currency exchange contracts and variable-to-fixed interest rate swaps as cash flow hedges as these derivative instruments mitigate the exposure to variability in the cash flows of forecasted transactions

attributable to foreign currency exchange and interest rates. Unless noted otherwise, we have also designated our derivative instruments as qualifying for hedge accounting treatment.

We did not de-designate any instruments from hedge accounting treatment during the three and nine months ended September 30, 2014 or 2013. Gains or losses related to hedge ineffectiveness recognized in earnings during the three and nine months ended September 30, 2014 and 2013 were not material. At September 30, 2014, the estimated amount of net gains, net of income tax expense, which are expected to be reclassified out of AOCI and into earnings within the next 12 months, is \$3.0 million if exchange and interest rates do not fluctuate from the levels at September 30, 2014.

We enter into foreign currency exchange contracts for amounts that are less than the full value of forecasted intercompany inventory purchases and sales. Our hedging strategy related to intercompany inventory purchases and sales is to employ the full amount of our hedges for the succeeding year at the conclusion of our budgeting process for that year. We primarily utilize foreign currency exchange contracts with durations of less than 24 months. Quarterly, we enter into contracts to hedge incremental portions of anticipated foreign currency transactions for the current and following year. As a result, our risk with respect to foreign currency exchange rate fluctuations and the notional value of foreign currency exchange contracts may vary throughout the year. The U.S. dollar is the currency purchased or sold in all of our foreign currency exchange contracts. The notional amount of foreign currency exchange contracts to hedge forecasted intercompany inventory purchases and sales totaled \$216.0 million and \$168.3 million at September 30, 2014 and December 31, 2013, respectively.

We have entered into forward fixed interest rate swap agreements to manage the economic effect of variable interest obligations on amounts borrowed under the terms of our Credit Facility. The variable interest rate associated with \$40 million of borrowings outstanding under the Credit Facility is effectively fixed at 1.36% plus the Credit Spread through June 30, 2016. Additionally, the variable interest rate associated with an additional \$40 million of borrowings outstanding under the Credit Facility is effectively fixed at 1.64% plus the Credit Spread through June 30, 2016.

The fair values of derivative instruments and their respective classification on the condensed consolidated balance sheets and amounts subject to offset under master netting arrangements consisted of the following (in thousands):

| | | Asset Derivatives | |
|--|------------------------------|-----------------------|----------------------|
| | | September 30, 2014 | December 31, 2013 |
| Derivatives designated as hedging instruments | Balance Sheet Classification | | |
| Foreign currency exchange contracts | Other current assets | \$ 6,015 | \$ 4,044 |
| Foreign currency exchange contracts | Other long-term assets, net | 1,277 | - |
| Total derivative instruments presented on the balance sheet | | 7,292 | 4,044 |
| Gross amounts subject to master netting arrangements not offset on the balance sheet | | 1,091 | 2,965 |
| Net amount | | \$ 6,201 | \$ 1,079 |

| | | Liability Derivatives | |
|--|------------------------------|-----------------------|----------------------|
| | | September 30, 2014 | December 31, 2013 |
| Derivatives designated as hedging instruments | Balance Sheet Classification | | |
| Foreign currency exchange contracts | Accrued liabilities | \$ 933 | \$ 3,096 |
| Foreign currency exchange contracts | Other long-term liabilities | 158 | - |
| Interest rate swaps | Accrued liabilities | 1,242 | 1,821 |
| Total derivative instruments presented on the balance sheet | | 2,333 | 4,917 |
| Gross amounts subject to master netting arrangements not offset on the balance sheet | | 1,091 | 2,965 |
| Net amount | | \$ 1,242 | \$ 1,952 |

The effect of derivative instruments designated as cash flow hedges on the condensed consolidated balance sheets consisted of the following (in thousands):

| | Gain (Loss) Recognized in AOCI on Derivative Instruments (Effective Portion) | | | |
|---|--|------------|---|----------|
| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
| Derivative instruments | 2014 | 2013 | 2014 | 2013 |
| Foreign currency exchange contracts, net of tax | \$ 5,775 | \$ (4,380) | \$ 3,560 | \$ 1,117 |
| Interest rate swaps, net of tax | 224 | (55) | 364 | 464 |
| Total derivative instruments, net of tax | \$ 5,999 | \$ (4,435) | \$ 3,924 | \$ 1,581 |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This Quarterly Report on Form 10-Q contains statements which, to the extent they are not statements of historical fact, constitute "forward-looking statements." Such forward-looking statements about our business and expectations within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, include statements relating to future revenue growth rates, earnings and other measures of financial performance; the effect of economic conditions on our business performance; demand for our products; realizability of assets; future cash flow and uses of cash; future repurchases of common stock; future levels of indebtedness and capital spending; interest expense; warranty expense; share-based compensation expense; and competition. Forward-looking statements can be identified by the use of words such as "expects," "may," "anticipates," "intends," "would," "will," "plans," "believes," "estimates," "should," and similar expressions. These forward-looking statements are intended to provide our current expectations or forecasts of future events, are based on current estimates, projections, beliefs, and assumptions, and are not guarantees of future performance. Actual events or results may differ materially from those described in the forward-looking statements. These forward-looking statements involve a number of risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report") and this Quarterly Report on Form 10-Q, as well as those described from time to time in our other periodic reports filed with the Securities and Exchange Commission (the "SEC").

Any forward-looking statements represent our estimates only as of the day this Quarterly Report on Form 10-Q was first filed with the SEC and should not be relied upon as representing our estimates as of any subsequent date. From time to time, oral or written forward-looking statements may also be included in other materials released to the public. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates or expectations change.

You should read the following discussion and analysis in conjunction with our 2013 Annual Report that includes additional information about us, our results of operations, our financial position and our cash flows, and with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

§ Business Overview and Trends

Operating Segments. We operate primarily through three business segments: diagnostic and information technology-based products and services for the veterinary market, which we refer to as the Companion Animal Group ("CAG"), water quality products ("Water") and diagnostic tests for livestock and poultry health and to ensure the quality and safety of milk and food, which we refer to as Livestock, Poultry and Dairy ("LPD"). Our Other operating segment combines and presents products for the human point-of-care medical diagnostics market ("OPTI Medical") with our pharmaceutical product line and our out-licensing arrangements because they do not meet the quantitative or qualitative thresholds for reportable segments.

CAG develops, designs, manufactures and distributes products and performs services for veterinarians and the bioresearch market, primarily related to diagnostics and information management. Water develops, designs, manufactures and distributes a range of products used in the detection of various microbiological parameters in water. LPD develops, designs, manufactures and distributes diagnostic tests and related instrumentation that are used to detect a wide range of diseases and monitor the health status in livestock and poultry, as well as products that ensure the quality and safety of milk and food. OPTI Medical develops, designs, manufactures and distributes point-of-care electrolyte and blood gas analyzers and related consumable products for the human medical diagnostics market.

Effects of Certain Factors on Results of Operations

Distributor Purchasing and Inventories. The instrument consumables and rapid assay products in our CAG segment are sold in the U.S. and certain other geographies by third party distributors, who purchase products from us and sell them to veterinary practices, which are the end users. As a result, distributor purchasing dynamics have an impact on our reported sales of these products. Distributor purchasing dynamics may be affected by many factors and in a given period may not be directly related to underlying end-user demand for our products. Consequently, reported results may reflect fluctuations in inventory levels held at distributors and may not necessarily reflect changes in underlying end-user demand. Therefore, we believe it is important to track distributor sales to end users by our significant distributors and to distinguish between the impact of end-user demand and the impact of distributor purchasing dynamics on reported revenue. We are unable to obtain data for sales to end users from certain less significant third party distributors internationally. We do not believe the impact of changes in these distributors' inventories would have a material impact on our growth rates.

Where growth rates are affected by changes in end-user demand, we refer to this as the impact of practice-level sales on growth. Where growth rates are affected by distributor purchasing dynamics, we refer to this as the impact of changes in distributors' inventories on growth. If during the current year, distributors' inventories grew by less than those inventories grew in the comparable period of the prior year, then changes in distributors' inventories have an unfavorable impact on our reported sales growth in the current period. Conversely, if during the current year distributors' inventories grew by more than those inventories grew in the comparable period of the prior year, then changes in distributors' inventories have a favorable impact on our reported sales growth in the current period.

We believe that our U.S. CAG distributors typically hold inventory equivalent to approximately three to four weeks of the anticipated end-user demand for VetLab consumables and rapid assay products at the end of a quarter.

Effective January 1, 2015, we plan to be fully transitioned to an all-direct sales strategy in the U.S. and will not renew our current annual contracts with our U.S. distribution partners. Under this approach, we intend to take orders, ship product, invoice and receive payment for all rapid assay test kits and instrument consumables in the U.S., aligning with our direct model for instruments, reference laboratory services, and other CAG products and services.

We have incurred and will continue to incur transition costs to implement this all-direct sales strategy in the U.S. We incurred approximately \$0.4 million during the third quarter of 2014 in incremental expense as we ramped up sales and operating resources. We now anticipate full year 2014 incremental expenses of approximately \$6 million related to the ramp of sales and operating resources, which is a reduction from our previous estimate of \$8 million reflecting the timing of resource additions. We also incurred \$4.3 million in non-recurring expenses during the third quarter of 2014 associated with project management and other one-time costs required to implement this new strategy. We continue to anticipate full year 2014 non-recurring expenses of \$10 million to \$12 million related to the all-direct transition.

Previously, we noted that further transitional impacts related to the drawdown of inventory held by distributors would occur primarily in the first quarter of 2015 and we would incur \$2 million to \$3 million in remaining project management expenses in early 2015. Given our progress in advancing operational plans to support the transition, we now expect one-time transitional impacts related to the drawdown of distributor inventory will occur primarily in the fourth quarter of 2014 and will result in a reduction in revenue and operating profit of \$18 million to \$23 million and \$15 million to \$19 million, respectively, which represents a decrease from our previous estimates of \$30 million to \$35 million, and \$23 million to \$27 million, respectively. The higher end of the estimated impact range corresponds with the full estimated impact of the inventory drawdown impact. To the degree that impacts are below the high end of the estimated impact range in 2014, there may be limited carryover revenue and operating profit impact in the first quarter of 2015. We now expect to incur limited additional project management expenses in early 2015.

On January 1, 2015, we will begin recognizing revenue on rapid assay kits and instrument consumables upon delivery to end users in the U.S., instead of at distribution. We continue to expect to capture an additional \$50 million to \$55 million in annual revenue on these direct sales. We estimate that annual operating profit associated with this incremental revenue stream will increase approximately \$5 million to \$8 million in 2015 and will continue to provide accretive benefits that will scale over time based on our expected future growth rates.

Also as a result of the transition to an all-direct sales strategy in the U.S., we anticipate increased working capital demands of approximately \$15 million to \$20 million, including inventory costs previously held by our distributors and incremental accounts receivable resulting from a potentially longer elapsed time to collect our receivables.

Currency Impact. For the three and nine months ended September 30, 2014, approximately 26% and 27%, respectively, of our consolidated revenue was derived from products manufactured in the U.S. and sold internationally in local currencies. For the three and nine months ended September 30, 2013, approximately 25% and 26%, respectively, of our consolidated revenue was derived from products manufactured in the U.S. and sold internationally in local currencies. Strengthening of the rate of exchange for the U.S. dollar relative to other currencies has a negative impact on our revenues derived in currencies other than the U.S. dollar and on profits of products manufactured in the U.S. and sold internationally, and a weakening of the U.S. dollar has the opposite effect. Similarly, to the extent that the U.S. dollar is stronger in current or future periods relative to the exchange rates in effect in the corresponding prior periods, our growth rate will be negatively affected. The impact of foreign currency denominated operating expenses and foreign currency denominated supply contracts partly offsets this exposure. Additionally, our designated hedges of intercompany inventory purchases and sales help delay the impact of certain exchange rate fluctuations on non-U.S. denominated revenues.

The impact on revenue resulting from changes in foreign currency exchange rates is not a measure defined by accounting principles generally accepted in the United States of America (“U.S. GAAP”), otherwise referred to herein as a non-GAAP financial measure. As exchange rates are an important factor in understanding period-to-period comparisons, we believe the presentation of results normalized for changes in currency in addition to reported results helps improve investors’ ability to understand our operating results and evaluate our performance in comparison to prior periods.

Effective January 1, 2014, we calculate the impact on revenue resulting from changes in foreign currency exchange rates by applying the difference between the weighted average exchange rates during the current year period and the comparable previous year period to foreign currency denominated revenues for the prior year period. Prior to January 1, 2014, we calculated this impact by applying the difference between the weighted average exchange rates during the current year period and the comparable previous year period to foreign currency denominated revenues for the current year period. This change in methodology, which was implemented to achieve operational efficiencies, has not had a material impact on organic revenue growth. See the subsection below titled “Results of Operations” for the definition of and other information regarding organic revenue growth.

During the three months ended September 30, 2014, as compared to the three months ended September 30, 2013, total company revenue attributable to changes in foreign currency exchange rates remained relatively consistent, as the weakening of the U.S. dollar against the British pound was almost entirely offset by the strengthening of the U.S. dollar against the Canadian dollar and Japanese yen.

During the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013, changes in foreign currency exchange rates increased total company revenue by approximately \$1.7 million, due primarily to the weakening of the U.S. dollar against the euro and British pound, partly offset by the strengthening of the U.S. dollar against the Canadian dollar, Australian dollar and Japanese yen.

Effects of Economic Conditions. Demand for our products and services is vulnerable to changes in the economic environment, including slow economic growth, high unemployment and credit availability. Negative or cautious consumer sentiment can lead to reduced or delayed consumer spending, resulting in a decreased number of patient visits to veterinary clinics. Unfavorable economic conditions can impact sales of instruments, digital radiography and practice management systems, which are larger capital purchases for veterinarians. Additionally, economic turmoil can cause our customers to remain sensitive to the pricing of our products and services. We monitor patient visits and clinic revenue data provided by a subset of our CAG customers. Although limited and susceptible to short-term impacts such as weather, we believe that this data provides a fair and meaningful long-term representation of the trend in patient visit activity in the U.S., providing us insight regarding demand for our products and services. We believe the overall trends in patient visits and capital investments since the beginning of the economic downturn in 2008 have had a slightly negative impact on our CAG segment revenue growth rates. Although the rate of growth has not been steady, we have seen an improvement in growth of patient visits since 2012.

Economic conditions can also affect the purchasing decisions of our Water and LPD business customers. In the past, water testing volumes have been susceptible to declines in discretionary testing and in mandated testing as a result of

decreases in home and commercial construction. Fiscal difficulties can also reduce government funding for water and livestock testing programs.

We believe that the diversity of our products and services and the geographic diversity of our markets partially mitigate the effects of the economic environment and negative consumer sentiment on our revenue growth rates.

Effects of Patent Expiration. Some of our patents and licenses of patents and technologies from third parties expired during the nine months ended September 30, 2014, and we expect other patents and licenses to expire prior to the end of 2015. However, the expiration of these patents and licenses, individually or in the aggregate, is not expected to have a material effect on our financial position or future operations due to a range of factors, including our brand strength and reputation in the marketplace; the breadth, quality and integration of our product offerings; our existing customer relationships and our customer support; our sales force; the applicable regulatory approval status for certain products; our continued investments in innovative product improvements that often result in new technologies and/or additional patents; and our significant know-how, scale and investments related to manufacturing processes of associated product offerings.

§ Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in Note 2 to the consolidated financial statements in our 2013 Annual Report. The critical accounting policies and the significant judgments and estimates used in the preparation of our condensed consolidated financial statements for the three and nine months ended September 30, 2014 are consistent with those discussed in our 2013 Annual Report in the section under the heading “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates.”

§ Results of Operations

The following revenue analysis and discussion focuses on organic revenue growth. Organic revenue growth is a non-GAAP financial measure and represents the percentage change in revenue during the three and nine months ended September 30, 2014, as compared to the same period for the prior year, net of the effect of changes in foreign currency exchange rates and acquisitions. 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. Management believes that reporting organic revenue growth provides useful information to investors by facilitating easier comparisons of our revenue performance with prior and future periods and to the performance of our peers. We exclude the effect of changes in foreign currency exchange rates because changes in foreign currency exchange rates are not under management’s control, are subject to volatility and can obscure underlying business trends. We exclude the effect of acquisitions because the nature, size and number of acquisitions can vary dramatically from period to period and therefore can also obscure underlying business trends.

Organic revenue growth and the percentage changes in revenue from foreign currency exchange rates and acquisitions are non-GAAP financial measures. See the subsection above titled “Effects of Certain Factors on Results of Operations – Currency Impact” for a description of the calculation of the percentage change in revenue resulting from changes in foreign currency exchange rates. The percentage change in revenue resulting from acquisitions represents incremental revenues attributable to acquisitions that have occurred since the beginning of the prior year period.

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Revenue

Total Company. The following table presents revenue by operating segment:

| Net Revenue (dollars in thousands) | For the Three Months Ended September 30, 2014 | For the Three Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---------------------------------------|--|--|------------------|----------------------|--|---|------------------------------|
| CAG | \$ 320,724 | \$ 283,843 | \$ 36,881 | 13.0% | - | 0.2% | 12.8% |
| Water | 25,747 | 23,247 | 2,500 | 10.8% | 0.5% | 1.3% | 9.0% |
| LPD | 29,648 | 25,131 | 4,517 | 18.0% | 0.1% | 4.0% | 13.9% |
| Other | 7,404 | 6,076 | 1,328 | 21.9% | 0.1% | - | 21.8% |
| Total | \$ 383,523 | \$ 338,297 | \$ 45,226 | 13.4% | - | 0.6% | 12.8% |

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U.S. and International Revenue. The following table provides further analysis of total company revenue by U.S. markets and non-U.S., or international, markets:

| Net Revenue (dollars in thousands) | For the Three Months Ended September 30, 2014 | For the Three Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---------------------------------------|--|--|------------------|----------------------|--|---|------------------------------|
| United States | \$ 225,310 | \$ 200,408 | \$ 24,902 | 12.4% | - | 0.1% | 12.3% |
| International | 158,213 | 137,889 | 20,324 | 14.7% | - | 1.3% | 13.4% |
| Total | \$ 383,523 | \$ 338,297 | \$ 45,226 | 13.4% | - | 0.6% | 12.8% |

The increase in both U.S. and international revenues was driven primarily by CAG Diagnostics recurring revenue. The increase in international revenues was driven by strong growth in Europe and Asia-Pacific markets, most significantly from the United Kingdom, Germany, Australia, France and China. The impact of changes in distributors' inventory levels increased reported U.S. revenue growth by 3%. The impact of changes in distributors' inventory levels did not have a significant impact on international revenue growth.

Companion Animal Group. The following table presents revenue by product and service category for CAG:

| Net Revenue (dollars in thousands) | For the Three Months Ended September 30, 2014 | For the Three Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---|--|--|------------------|----------------------|--|---|------------------------------|
| CAG Diagnostics recurring revenue: | \$ 277,957 | \$ 242,163 | \$ 35,794 | 14.8% | 0.1% | 0.3% | 14.4% |
| VetLab consumables | 90,971 | 76,080 | 14,891 | 19.6% | 0.3% | - | 19.3% |
| VetLab service and accessories | 13,716 | 12,749 | 967 | 7.6% | (0.3%) | - | 7.9% |
| Rapid assay products | 46,777 | 43,042 | 3,735 | 8.7% | (0.1%) | - | 8.8% |
| Reference laboratory diagnostic and consulting services | 126,493 | 110,292 | 16,201 | 14.7% | - | 0.7% | 14.0% |
| CAG Diagnostics capital - instruments | 18,040 | 19,115 | (1,075) | (5.6%) | (0.9%) | - | (4.7%) |
| Customer information | | | | | | | |

| | | | | | | | |
|--|------------|------------|-----------|-------|--------|------|-------|
| management and digital imaging systems | 24,727 | 22,565 | 2,162 | 9.6% | (0.3%) | - | 9.9% |
| Net CAG revenue | \$ 320,724 | \$ 283,843 | \$ 36,881 | 13.0% | - | 0.2% | 12.8% |

The increase in CAG Diagnostics recurring revenue was due primarily to increased volumes and higher realized prices in both our reference laboratory diagnostic services and our VetLab consumables. The impact of changes in distributors' inventory levels increased reported CAG Diagnostics recurring revenue growth by 2%.

VetLab consumables revenue growth was due primarily to higher unit volumes. The increase in unit volumes resulted primarily from growth of our installed base of Catalyst Dx® and ProCyte Dx® instruments as a result of new customer acquisitions, as well as an increase in testing from existing customers, including those who upgraded to these instruments. Additionally, VetLab consumables revenue benefited from higher average unit sales prices resulting from price increases. The impact of changes in distributors' inventory levels increased reported consumables revenue growth by 5%.

VetLab service and accessories revenue growth was primarily a result of the increase in our installed base of instruments.

The increase in rapid assay revenue was due primarily to higher sales of both our canine and feline testing products resulting from an increase in U.S. practice-level sales volumes and price increases. The impact of changes in distributors' inventory levels increased reported rapid assay revenue growth by 4%.

The increase in reference laboratory diagnostic and consulting services revenue was due primarily to the impact of higher volumes throughout our worldwide network of laboratories resulting from increased testing from existing customers and the acquisition of new customers. Additionally, the increase in revenue was the result of higher average unit sales prices due to price increases.

The decrease in CAG Diagnostics capital instruments revenue was due primarily to the unfavorable impact of deferred revenue associated with preorders for our upcoming Catalyst One™ analyzer and the impact of lower realized prices. Under our Catalyst One introductory offer, customers are provided with the right to use a Catalyst Dx instrument through the Catalyst One release date. As a result, we do not recognize instrument revenue for preorders relating to the Catalyst One introductory offer until the Catalyst One is delivered. These unfavorable impacts were partly offset by higher placements of our ProCytte hematology instrument in Europe and the U.S. For the three months ended September 30, 2014, nearly all of SNAP Pro® Mobile Device placements were made under a reagent rental program for which instrument revenue will be recognized with the future sale of consumables.

The increase in customer information management and digital imaging systems revenue was due primarily to higher support revenue, resulting from an increase in our installed base of practice management and digital imaging systems, and a growing Pet Health Network® Pro subscriber base.

Water. The increase in Water revenue resulted from higher sales volumes of our Colilert® products, due primarily to the acquisition of new customers in Europe and the United States.

Livestock, Poultry and Dairy. The increase in LPD revenue was due primarily to higher sales volumes of bovine test products worldwide. To a lesser extent, higher revenues also resulted from increased sales volumes of poultry tests in Europe. We continue to anticipate lower sales volumes of bovine test products in Europe resulting from the success of certain eradication programs and changes in Bovine Spongiform Encephalopathy (“BSE”) testing requirements, though we expect that these revenue declines will not be realized until 2015. The acquisition of a Brazilian distributor of our LPD products in the third quarter of 2013 added 4% to reported revenue growth for the three months ended September 30, 2014 as compared to the same period of the prior year.

Other. The increase in Other revenue resulted from higher sales volumes of consumables used with our OPTI Medical instruments and milestone revenue from our pharmaceutical out-licensing arrangements earned during the three months ended September 30, 2014.

Gross Profit

Total Company. The following table presents gross profit and gross profit percentages by operating segment:

| | For the Three Months Ended | Percent of | For the Three Months Ended | Percent of | Dollar | Percentage |
|--------------|-------------------------------------|---------------|-------------------------------------|---------------|--------|------------|
| Gross Profit | | | | | | |

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| (dollars in thousands) | September | | September | | Change | Change |
|------------------------|------------|---------|------------|---------|-----------|----------|
| | 30, 2014 | Revenue | 30, 2013 | Revenue | | |
| CAG | \$ 176,036 | 54.9% | \$ 152,359 | 53.7% | \$ 23,677 | 15.5% |
| Water | 17,341 | 67.4% | 15,598 | 67.1% | 1,743 | 11.2% |
| LPD | 17,970 | 60.6% | 13,140 | 52.3% | 4,830 | 36.8% |
| Other | 3,986 | 53.8% | 2,978 | 49.0% | 1,008 | 33.8% |
| Unallocated amounts | (1,997) | N/A | 1,708 | N/A | (3,705) | (216.9%) |
| Total Company | \$ 213,336 | 55.6% | \$ 185,783 | 54.9% | \$ 27,553 | 14.8% |

Companion Animal Group. Gross profit for CAG increased due to higher sales and an increase in the gross profit percentage to 55% from 54%. The increase in gross profit percentage was due primarily to lower overall VetLab product costs, price increases across our CAG Diagnostics recurring revenue portfolio and efficiencies realized throughout our reference laboratory operations.

Water. Gross profit for Water increased due primarily to higher sales. The slight increase in the gross profit percentage was due primarily to a decrease in overall manufacturing costs resulting from higher production volumes and a more favorable product mix consisting of higher relative sales of our Colilert products. These favorable impacts were partly offset by lower average unit sales prices in Latin America and Australia, and the unfavorable impact of currency resulting from lower relative hedging gains during the three months ended September 30, 2014 as compared to the same period of the prior year.

Livestock, Poultry and Dairy. Gross profit for LPD increased due primarily to an improvement in the gross profit percentage to 61% from 52% and higher sales. The increase in the gross profit percentage was due primarily to lower overall manufacturing costs driven by higher production volumes and, to a lesser extent, higher realized prices resulting from the acquisition of our distributor in Brazil in the third quarter of 2013.

Other. Gross profit for Other increased due to higher sales and an improvement in the gross profit percentage to 54% from 49%. The increase in the gross profit percentage was due primarily to milestone revenue related to our pharmaceutical out-licensing arrangements, for which there is no associated cost of revenue, and lower overall product costs in our OPTI Medical business. These favorable impacts were partly offset by lower average unit sales prices realized on our OPTI Medical instruments.

Unallocated Amounts. Gross profit for Unallocated Amounts decreased due primarily to an increase in certain manufacturing costs and changes in certain currency exchange rates.

The manufacturing costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption "Unallocated Amounts." The net unfavorable impact to gross profit as a result of increased manufacturing costs was due to the capitalization of favorable manufacturing variances, primarily in our LPD business, during the three months ended September 30, 2014.

In certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption "Unallocated Amounts." The U.S. dollar strengthened significantly against the Japanese yen from the beginning of the prior fiscal year through September 30, 2013. The strengthening in the value of the U.S. dollar relative to the Japanese yen from the beginning of the current fiscal year through September 30, 2014 was less significant as compared to the same period of the prior year, resulting in a lower favorable variance within Unallocated Amounts relating to the cost of products sold in Japanese yen.

Operating Expenses and Operating Income

Total Company. The following tables present operating expenses and operating income by operating segment:

| | For the | | For the | | Dollar | Percentage |
|------------------------|-----------|---------|-----------|---------|--------|------------|
| | Three | Percent | Three | Percent | | |
| Operating Expenses | Months | of | Months | of | | |
| (dollars in thousands) | Ended | Revenue | Ended | Revenue | Change | Change |
| | September | | September | | | |
| | 30, 2014 | | 30, 2013 | | | |

| | | | | | | |
|---------------------|------------|-------|------------|-------|-----------|--------|
| CAG | \$ 113,428 | 35.4% | \$ 99,648 | 35.1% | \$ 13,780 | 13.8% |
| Water | 5,974 | 23.2% | 5,184 | 22.3% | 790 | 15.2% |
| LPD | 14,084 | 47.5% | 12,015 | 47.8% | 2,069 | 17.2% |
| Other | 3,192 | 43.1% | 2,366 | 38.9% | 826 | 34.9% |
| Unallocated amounts | 4,469 | N/A | 1,085 | N/A | 3,384 | 311.9% |
| Total Company | \$ 141,147 | 36.8% | \$ 120,298 | 35.6% | \$ 20,849 | 17.3% |

| Operating Income (dollars in thousands) | For the Three Months Ended September 30, 2014 | | For the Three Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|--|--------------------------|--|----------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Dollar Change | Percentage Change | | |
| CAG | \$ 62,608 | 19.5% | \$ 52,711 | 18.6% | \$ 9,897 | 18.8% |
| Water | 11,367 | 44.1% | 10,414 | 44.8% | 953 | 9.2% |
| LPD | 3,886 | 13.1% | 1,125 | 4.5% | 2,761 | 245.4% |
| Other | 794 | 10.7% | 612 | 10.1% | 182 | 29.7% |
| Unallocated amounts | (6,466) | N/A | 623 | N/A | (7,089) | (1,137.9%) |
| Total Company | \$ 72,189 | 18.8% | \$ 65,485 | 19.4% | \$ 6,704 | 10.2% |

We incurred transition costs to implement an all-direct sales strategy within our CAG segment of approximately \$4.8 million during the third quarter of 2014. For the three months ended September 30, 2014, Total Company operating income adjusted for the aforementioned transition costs was approximately \$76.9 million and 20.1% of revenue, which represents an increase in operating income adjusted for transition costs of approximately \$11.5 million and 17.5%, as compared to the three months ended September 30, 2013. Operating income adjusted for transition costs is a non-GAAP financial measure and should be considered in addition to, and not as a replacement for or as a superior measure to, operating income reported in accordance with U.S. GAAP. Management believes that reporting operating income excluding transition costs provides useful information to investors by facilitating easier comparisons of our operating income performance with prior and future periods and to the performance of our peers.

See the subsection above titled “Effects of Certain Factors on Results of Operations – Distributor Purchasing and Inventories” for details regarding anticipated transitional costs related to moving to an all-direct sales strategy for VetLab consumables and rapid assay products and services within our CAG segment in the U.S.

Companion Animal Group. The following table presents CAG operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the | Percent of Revenue | For the | Percent of Revenue | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Three Months Ended September 30, 2014 | | Three Months Ended September 30, 2013 | | | |
| Sales and marketing | \$ 60,737 | 18.9% | \$ 51,932 | 18.3% | \$ 8,805 | 17.0% |
| General and administrative | 34,874 | 10.9% | 32,067 | 11.3% | 2,807 | 8.8% |
| Research and development | 17,817 | 5.6% | 15,649 | 5.5% | 2,168 | 13.9% |
| Total operating expenses | \$ 113,428 | 35.4% | \$ 99,648 | 35.1% | \$ 13,780 | 13.8% |

The increase in sales and marketing expense resulted from non-recurring consulting costs related to the aforementioned implementation of an all-direct sales strategy in the U.S., as well as higher personnel-related costs across all major regions, including our North American sales force transformation beginning in the second half of 2013 and increased commissions resulting from improved sales performance. The increase in general and administrative expense resulted primarily from higher personnel-related costs and, to a lesser extent, depreciation of internal-use software. The increase in research and development expense resulted primarily from higher personnel-related costs and increased materials costs, partly offset by lower external consulting and development costs.

Water. The following table presents Water operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the | Percent of Revenue | For the | Percent of Revenue | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Three Months Ended September 30, 2014 | | Three Months Ended September 30, 2013 | | | |
| Sales and marketing | \$ 2,896 | 11.2% | \$ 2,443 | 10.5% | \$ 453 | 18.5% |
| General and administrative | 2,336 | 9.1% | 2,114 | 9.1% | 222 | 10.5% |
| Research and development | 742 | 2.9% | 627 | 2.7% | 115 | 18.3% |
| Total operating expenses | \$ 5,974 | 23.2% | \$ 5,184 | 22.3% | \$ 790 | 15.2% |

The increase in sales and marketing expense was due primarily to higher personnel-related costs, including commissions related to improved sales performance, and incremental costs associated with the acquisition of our distributor in South Africa in the fourth quarter of 2013. The increase in general and administrative expense resulted primarily from higher personnel-related costs. The increase in research and development expense was due primarily to higher materials costs.

Livestock, Poultry and Dairy. The following table presents LPD operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the Three Months Ended September 30, 2014 | | For the Three Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|--|--------------------------|--|----------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Dollar Change | Percentage Change | | |
| Sales and marketing | \$ 6,380 | 21.5% | \$ 5,071 | 20.2% | \$ 1,309 | 25.8% |
| General and administrative | 4,564 | 15.4% | 3,945 | 15.7% | 619 | 15.7% |
| Research and development | 3,140 | 10.6% | 2,999 | 11.9% | 141 | 4.7% |
| Total operating expenses | \$ 14,084 | 47.5% | \$ 12,015 | 47.8% | \$ 2,069 | 17.2% |

The increase in sales and marketing expense resulted from higher personnel-related costs, including incremental costs associated with the acquisition of a Brazilian distributor in the third quarter of 2013 and commercial team investments worldwide, most significantly in the Asia-Pacific region. The increase in general and administrative expense resulted from the impairment of an intangible asset and incremental costs associated with the acquisition of the Brazilian distributor, consisting primarily of amortization of the acquired intangible assets and higher personnel-related costs. Research and development expense for the three months ended September 30, 2014 was generally consistent with the same period of the prior year.

Other. Operating expenses for Other increased \$0.8 million to \$3.2 million for the three months ended September 30, 2014, as compared to the same period of the prior year, due primarily to higher external development and consulting costs and an increase in personnel-related costs in our OPTI Medical business.

Unallocated Amounts. Operating expenses that are not allocated to our operating segments increased by \$3.4 million to \$4.5 million for the three months ended September 30, 2014, as compared to the same period of the prior year, due primarily to an increase in certain personnel-related costs and certain foreign exchange losses. In September 2014, the U.S. dollar experienced a continued and persistent strengthening relative to the euro, resulting in realized and unrealized losses on monetary assets, partly offset by gains on liabilities denominated in a currency other than the U.S. dollar. These favorable impacts were partly offset by a tax credit received under a state employment tax reimbursement program. We estimate certain personnel-related costs and allocate the estimated expenses to the operating segments. This allocation differs from actual expense and consequently yields a difference that is reported under the caption "Unallocated Amounts."

Interest Income and Interest Expense

Interest income was \$0.3 million and \$0.5 million for the three months ended September 30, 2014 and 2013, respectively. The decrease in interest income was the result of our disposition of a debt investment and repayment of the related notes receivable in June 2014. See Note 4 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the disposition of this strategic investment.

Interest expense was \$4.3 million for the three months ended September 30, 2014, as compared to \$1.5 million for the same period of the prior year. The increase in interest expense was due primarily to senior notes that we issued and sold through three private placements between December 2013 and September 2014 in an aggregate principal amount of \$350 million. Interest rates on the senior notes range from 3.32% to 4.04%. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Provision for Income Taxes

Our effective income tax rates were 23.5% and 29.1% for the three months ended September 30, 2014 and 2013, respectively. The decrease in our effective income tax rate for the three months ended September 30, 2014, as compared to the same period of the prior year, was related to a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error, which is not material to current or prior interim or annual periods, and higher relative earnings subject to international tax rates that are lower than domestic tax rates. These favorable factors were partly offset by the U.S. research and development ("R&D") tax credit which was not available during the three months ended September 30, 2014 because the legislation expired as of January 1, 2014.

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

Revenue

Total Company. The following table presents revenue by operating segment:

| Net Revenue (dollars in thousands) | For the Nine Months Ended September 30, 2014 | For the Nine Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---------------------------------------|---|--|------------------|----------------------|--|---|------------------------------|
| CAG | \$ 949,009 | \$ 856,617 | \$ 92,392 | 10.8% | - | 0.2% | 10.6% |
| Water | 71,655 | 66,297 | 5,358 | 8.1% | 0.4% | 1.3% | 6.4% |
| LPD | 93,738 | 81,448 | 12,290 | 15.1% | 1.2% | 5.7% | 8.2% |
| Other | 19,446 | 18,623 | 823 | 4.4% | 0.2% | - | 4.2% |
| Total | \$ 1,133,848 | \$ 1,022,985 | \$ 110,863 | 10.8% | 0.1% | 0.7% | 10.0% |

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U.S. and International Revenue. The following table provides further analysis of total company revenue by U.S. markets and non-U.S., or international, markets:

| Net Revenue (dollars in thousands) | For the Nine Months Ended September 30, 2014 | For the Nine Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---------------------------------------|--|--|------------------|----------------------|--|---|------------------------------|
| United States | \$ 658,240 | \$ 602,332 | \$ 55,908 | 9.3% | 0.1% | - | 9.2% |
| International | 475,608 | 420,653 | 54,955 | 13.1% | 0.3% | 1.6% | 11.2% |
| Total | \$ 1,133,848 | \$ 1,022,985 | \$ 110,863 | 10.8% | 0.1% | 0.7% | 10.0% |

The increase in both U.S. and international revenues was primarily driven by CAG Diagnostics recurring revenue. The increase in international revenues was driven by strong growth in Europe and Asia-Pacific markets, most significantly from the United Kingdom, Germany, Australia, China and France. The impact of changes in distributors' inventory levels did not have a significant impact on reported U.S. or international revenue growth.

Companion Animal Group. The following table presents revenue by product and service category for CAG:

| Net Revenue (dollars in thousands) | For the Nine Months Ended September 30, 2014 | For the Nine Months Ended September 30, 2013 | Dollar Change | Percentage Change | Percentage Change from Currency | Percentage Change from Acquisitions | Organic Revenue Growth |
|---|---|---|------------------|----------------------|--|---|------------------------------|
| CAG Diagnostics recurring revenue: | \$ 818,327 | \$ 734,989 | \$ 83,338 | 11.3% | - | 0.2% | 11.1% |
| VetLab consumables | 264,405 | 230,637 | 33,768 | 14.6% | 0.2% | - | 14.4% |
| VetLab service and accessories | 40,332 | 37,312 | 3,020 | 8.1% | 0.5% | - | 7.6% |
| Rapid assay products | 139,329 | 133,182 | 6,147 | 4.6% | (0.2%) | - | 4.8% |
| Reference laboratory diagnostic and consulting services | 374,261 | 333,858 | 40,403 | 12.1% | (0.1%) | 0.4% | 11.8% |
| CAG Diagnostics capital - instruments | 55,508 | 55,702 | (194) | (0.3%) | 0.5% | - | (0.8%) |
| Customer information management and digital imaging systems | 75,174 | 65,926 | 9,248 | 14.0% | (0.5%) | - | 14.5% |

| | | | | | | | |
|-----------------|------------|------------|-----------|-------|---|------|-------|
| Net CAG revenue | \$ 949,009 | \$ 856,617 | \$ 92,392 | 10.8% | - | 0.2% | 10.6% |
|-----------------|------------|------------|-----------|-------|---|------|-------|

The increase in CAG Diagnostics recurring revenue was due primarily to increased volumes and higher realized prices in both our reference laboratory diagnostic services and our VetLab consumables. The impact of changes in distributors' inventory levels did not have a significant impact on reported CAG Diagnostics recurring revenue.

VetLab consumables revenue growth was due primarily to higher unit volumes. The increase in unit volumes resulted primarily from growth of our installed base of Catalyst Dx and ProCyt Dx instruments as a result of new customer acquisitions, as well as an increase in testing from existing customers, including those who upgraded to these instruments. Additionally, VetLab consumables revenue benefited from higher average unit sales prices resulting from price increases. These favorable impacts were partly offset by lower consumables volumes from our VetTest® chemistry instrument as customers continue to upgrade from our VetTest instrument to our Catalyst instruments. The impact of changes in distributors' inventory levels did not have a significant impact on reported consumables revenue growth.

VetLab service and accessories revenue growth was primarily a result of the increase in our installed base of instruments.

The increase in rapid assay revenue was due primarily to higher sales of both our canine and feline testing products, resulting from both higher average unit sales prices and an increase in U.S. practice-level sales volumes. These favorable factors were partly offset by the impact of changes in distributors' inventory levels, which reduced reported rapid assay revenue growth by 2%.

The increase in reference laboratory diagnostic and consulting services revenue was due primarily to the impact of higher volumes throughout our worldwide network of laboratories resulting from increased testing from existing customers, the acquisition of new customers and improved customer retention. Additionally, the increase in revenue was the result of higher average unit sales prices due to price increases.

The decrease in CAG Diagnostics capital instruments revenue was due primarily to the unfavorable impact of deferred revenue associated with preorders for our upcoming Catalyst One analyzer and the impact of lower realized prices. Under our Catalyst One introductory offer, customers are provided with the right to use a Catalyst Dx instrument through the Catalyst One release date. As a result, we do not recognize instrument revenue for preorders relating to the Catalyst One introductory offer until the Catalyst One is delivered. These unfavorable impacts were partly offset by higher placements of our Catalyst Dx and ProCyte Dx instruments, primarily in Europe and the Asia-Pacific region. For the nine months ended September 30, 2014, the majority of SNAP Pro Mobile Device placements were made under a reagent rental program for which instrument revenue will be recognized with the future sale of consumables.

The increase in customer information management and digital imaging systems revenue was due primarily to a growing Pet Health Network Pro subscriber base, higher support revenue resulting from an increase in our installed base of practice management and digital imaging systems and higher revenue from hardware upgrades as a result of Microsoft ending support for Windows XP.

Water. The increase in Water revenue resulted from higher revenue from our Colilert products and related accessories, due primarily to higher sales volumes in North America, Europe and the Asia-Pacific region resulting from the acquisition of new customers.

Livestock, Poultry and Dairy. The increase in LPD revenue was due primarily to higher sales of certain bovine test products in the Asia-Pacific region, higher volumes in Europe of our milk-based bovine pregnancy test, and higher sales in China of Dairy SNAP® tests used for the detection of antibiotic residues in milk. We continue to anticipate lower sales volumes of bovine test products in Europe resulting from the success of certain eradication programs and changes in BSE testing requirements, though we expect that these revenue declines will not be realized until 2015. The acquisition of a Brazilian distributor of our LPD products in the third quarter of 2013 added 6% to reported revenue growth for the nine months ended September 30, 2014 as compared to the same period of the prior year.

Other. The increase in Other revenue was due primarily to higher sales volumes associated with our OPTI Medical consumables and pharmaceutical product line. These favorable impacts were partly offset by lower sales of our OPTI Medical instruments in Latin America.

Gross Profit

Total Company. The following table presents gross profit and gross profit percentages by operating segment:

| Gross Profit (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Percent of Revenue | Percent of Revenue | | |
| CAG | \$ 522,908 | 55.1% | \$ 464,301 | 54.2% | \$ 58,607 | 12.6% |
| Water | 47,379 | 66.1% | 44,136 | 66.6% | 3,243 | 7.3% |
| LPD | 58,612 | 62.5% | 44,270 | 54.4% | 14,342 | 32.4% |
| Other | 10,130 | 52.1% | 9,235 | 49.6% | 895 | 9.7% |
| Unallocated amounts | (5,078) | N/A | 5,511 | N/A | (10,589) | (192.1%) |
| Total Company | \$ 633,951 | 55.9% | \$ 567,453 | 55.5% | \$ 66,498 | 11.7% |

Companion Animal Group. Gross profit for CAG increased due to higher sales and an increase in the gross profit percentage to 55% from 54%. The increase in gross profit percentage was due primarily to lower overall VetLab product costs and price increases across our CAG Diagnostics recurring revenue portfolio.

Water. Gross profit for Water increased due primarily to higher sales, partly offset by a decrease in the gross profit percentage to 66% from 67%. The decrease in gross profit percentage was due primarily to the unfavorable impact of currency resulting from hedging losses during the nine months ended September 30, 2014 as compared to hedging gains during the same period of the prior year, partly offset by a more favorable product mix consisting of higher relative sales of our Colilert products.

Livestock, Poultry and Dairy. Gross profit for LPD increased due to an improvement in the gross profit percentage to 63% from 54% and higher sales. The increase in the gross profit percentage resulted from lower overall manufacturing costs driven by higher production volumes and a decrease in royalty expense. The decrease in royalty expense was due primarily to an agreement executed in the first quarter of 2014 with a licensor of patents related to the sale of certain swine tests. A portion of the favorability resulting from this agreement will not recur.

Other. Gross profit for Other increased due to an improvement in the gross profit percentage to 52% from 50% and higher sales. The increase in the gross profit percentage was due primarily to our OPTI Medical business, resulting from favorable product mix due to higher relative sales of consumables and lower overall manufacturing costs.

Unallocated Amounts. Gross profit for Unallocated Amounts decreased due primarily to an increase in certain manufacturing costs and changes in certain currency exchange rates.

The manufacturing costs reported in our operating segments include our standard cost for products sold and any variances from standard cost for products purchased or manufactured within the period. We capitalize these variances for inventory on hand at the end of the period to record inventory in accordance with U.S. GAAP. We then record these variances as cost of product revenue as that inventory is sold. The impact to cost of product revenue resulting from this variance capitalization and subsequent recognition is reported within the caption "Unallocated Amounts." The net unfavorable impact to gross profit as a result of increased manufacturing costs was due to the capitalization of favorable manufacturing variances, primarily within our LPD business, during the nine months ended September 30, 2014.

In certain geographies where we maintain inventories in currencies other than the U.S. dollar, the product costs reported in our operating segments include our standard cost for products sold, which is stated at the budgeted currency exchange rate from the beginning of the fiscal year. In these geographies, the variances from standard cost for products sold related to changes in currency exchange rates are reported within the caption "Unallocated Amounts." The U.S. dollar strengthened significantly against the Japanese yen from the beginning of the prior fiscal year through September 30, 2013. The strengthening in the value of the U.S. dollar relative to the Japanese yen from the beginning of the current fiscal year through September 30, 2014 was less significant, as compared to the same period of the prior year, resulting in a lower favorable variance within Unallocated Amounts relating to the cost of products sold in Japanese yen.

Operating Expenses and Operating Income

Total Company. The following tables present operating expenses and operating income by operating segment:

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| Operating Expenses (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Percent of Revenue | Percent of Revenue | | |
| CAG | \$ 334,088 | 35.2% | \$ 296,924 | 34.7% | \$ 37,164 | 12.5% |
| Water | 17,832 | 24.9% | 15,454 | 23.3% | 2,378 | 15.4% |
| LPD | 40,943 | 43.7% | 35,094 | 43.1% | 5,849 | 16.7% |
| Other | 8,996 | 46.3% | 7,347 | 39.5% | 1,649 | 22.4% |
| Unallocated amounts | 6,638 | N/A | 7,200 | N/A | (562) | (7.8%) |
| Total Company | \$ 408,497 | 36.0% | \$ 362,019 | 35.4% | \$ 46,478 | 12.8% |

| Operating Income (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Percent of Revenue | Percent of Revenue | | |
| CAG | \$ 188,820 | 19.9% | \$ 167,377 | 19.5% | \$ 21,443 | 12.8% |
| Water | 29,547 | 41.2% | 28,682 | 43.3% | 865 | 3.0% |
| LPD | 17,669 | 18.8% | 9,176 | 11.3% | 8,493 | 92.6% |
| Other | 1,134 | 5.8% | 1,888 | 10.1% | (754) | (39.9%) |
| Unallocated amounts | (11,716) | N/A | (1,689) | N/A | (10,027) | (593.7%) |
| Total Company | \$ 225,454 | 19.9% | \$ 205,434 | 20.1% | \$ 20,020 | 9.7% |

We incurred transition costs to implement an all-direct sales strategy in the U.S. within our CAG segment of approximately \$4.8 million during the third quarter of 2014. For the nine months ended September 30, 2014, Total Company operating income adjusted for the aforementioned transition costs was approximately \$230.2 million and 20.3% of revenue, which represents an increase in adjusted operating income of \$20.7 million and 10.1%, as compared to the nine months ended September 30, 2013, which is adjusted for the 2013 bankruptcy of a third-party service provider of approximately \$4.1 million. Adjusted operating income is a non-GAAP financial measure and should be considered in addition to, and not as a replacement for or as a superior measure to, operating income reported in accordance with U.S. GAAP. Management believes that reporting adjusted operating income provides useful information to investors by facilitating easier comparisons of our operating income performance with prior and future periods and to the performance of our peers.

See the subsection above titled “Effects of Certain Factors on Results of Operations – Distributor Purchasing and Inventories” for details regarding anticipated transitional costs related to moving to an all-direct sales strategy for VetLab consumables and rapid assay products and services within our CAG segment in the U.S.

Companion Animal Group. The following table presents CAG operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|----------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Dollar Change | Percentage Change | | |
| Sales and marketing | \$ 177,442 | 18.7% | \$ 154,765 | 18.1% | \$ 22,677 | 14.7% |
| General and administrative | 104,159 | 11.0% | 94,858 | 11.1% | 9,301 | 9.8% |
| Research and development | 52,487 | 5.5% | 47,301 | 5.5% | 5,186 | 11.0% |
| Total operating expenses | \$ 334,088 | 35.2% | \$ 296,924 | 34.7% | \$ 37,164 | 12.5% |

The increase in sales and marketing expense resulted from higher personnel-related costs across all major regions, including our North American sales force transformation started in the second half of 2013 and increased commissions resulting from improved sales performance; and non-recurring consulting costs related to the aforementioned implementation of an all-direct sales strategy in the U.S. The increase in general and administrative expense resulted primarily from higher personnel-related costs and, to a lesser extent, depreciation of internal-use software. The increase in research and development expense resulted primarily from higher personnel-related costs and increased materials costs, partly offset by lower external consulting and development costs.

Water. The following table presents Water operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Percent of Revenue | Percent of Revenue | | |
| Sales and marketing | \$ 8,572 | 12.0% | \$ 7,262 | 11.0% | \$ 1,310 | 18.0% |
| General and administrative | 6,942 | 9.7% | 6,298 | 9.5% | 644 | 10.2% |
| Research and development | 2,318 | 3.2% | 1,894 | 2.9% | 424 | 22.4% |
| Total operating expenses | \$ 17,832 | 24.9% | \$ 15,454 | 23.3% | \$ 2,378 | 15.4% |

The increase in sales and marketing expense was due primarily to higher personnel-related costs, including commissions related to improved sales performance, and incremental costs associated with the acquisition of our distributor in South Africa in the fourth quarter of 2013. The increase in general and administrative expense resulted primarily from higher personnel-related costs. The increase in research and development expense was due primarily to higher materials costs.

Livestock, Poultry and Dairy. The following table presents LPD operating expenses by functional area:

| Operating Expenses (dollars in thousands) | For the Nine Months Ended September 30, 2014 | | For the Nine Months Ended September 30, 2013 | | Dollar Change | Percentage Change |
|--|---|--------------------------|---|--------------------------|------------------|----------------------|
| | Percent of Revenue | Percent of Revenue | Percent of Revenue | Percent of Revenue | | |
| Sales and marketing | \$ 18,413 | 19.6% | \$ 14,953 | 18.4% | \$ 3,460 | 23.1% |
| General and administrative | 12,776 | 13.6% | 10,855 | 13.3% | 1,921 | 17.7% |
| Research and development | 9,754 | 10.4% | 9,286 | 11.4% | 468 | 5.0% |
| Total operating expenses | \$ 40,943 | 43.7% | \$ 35,094 | 43.1% | \$ 5,849 | 16.7% |

The increase in sales and marketing expense resulted from higher personnel-related costs, including incremental costs associated with the acquisition of a Brazilian distributor in the third quarter of 2013 and commercial team investments worldwide, most significantly in the Asia-Pacific region. The increase in general and administrative expense resulted from incremental costs associated with the acquisition of the Brazilian distributor, primarily personnel-related costs and higher amortization of the acquired intangible assets, the impairment of an intangible asset and the unfavorable impact of changes in foreign currency exchange rates. The increase in research and development expense was due primarily to higher personnel-related costs and the unfavorable impact of changes in foreign currency exchange rates.

Other. Operating expenses for Other increased \$1.6 million to \$9.0 million for the nine months ended September 30, 2014, as compared to the same period of the prior year due primarily to higher external development and consulting costs and an increase in personnel-related costs in our OPTI Medical line of business.

Unallocated Amounts. Operating expenses that are not allocated to our operating segments decreased by \$0.6 million to \$6.6 million for the nine months ended September 30, 2014, as compared to the same period of the prior year, due primarily to the absence of a \$4.1 million loss incurred during the nine months ended September 30, 2013 resulting from the bankruptcy of a freight payment and audit service provider and by a tax credit received under a state employment tax reimbursement program. These favorable factors were partly offset by an increase in certain personnel-related costs and certain foreign exchange losses. In September 2014, the U.S. dollar experienced a continued and persistent strengthening relative to the euro, resulting in realized and unrealized losses on monetary assets, partly offset by gains on liabilities denominated in a currency other than the U.S. dollar.

Interest Income and Interest Expense

Interest income was \$1.3 million for both the nine months ended September 30, 2014 and 2013. For the remainder of 2014, we anticipate a reduction in interest income as a result of our June 2014 disposition of a debt investment and repayment of the related notes receivable. See Note 4 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding the disposition of this strategic investment.

Interest expense was \$10.0 million for the nine months ended September 30, 2014, as compared to \$3.5 million for the same period of the prior year. The increase in interest expense was due primarily to senior notes that we issued and sold through three private placements between December 2013 and September 2014 in an aggregate principal amount of \$350 million. Interest rates on the senior notes range from 3.32% to 4.04%. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Provision for Income Taxes

Our effective income tax rates were 28.0% and 28.9% for the nine months ended September 30, 2014 and 2013, respectively. The decrease in our effective income tax rate for the nine months ended September 30, 2014, as compared to the same period of the prior year, was related to higher relative earnings subject to international tax rates that are lower than domestic tax rates, a non-recurring benefit related to the deferral of intercompany profits that were included in prior year tax provisions in error and the resolution of domestic and international tax audits, which resulted in a net reduction in our provision for uncertain tax positions. These favorable factors were partly offset by the R&D tax credit, which expired as of January 1, 2014. During the three months ended March 31, 2013, legislation in the U.S. retroactively allowed the R&D tax credit for all of 2012 and extended the R&D tax credit through the year ending December 31, 2013. Because this legislation was enacted during the three months ended March 31, 2013, the full benefit of the credit related to the prior years' activities was recognized within that quarter.

§ Recent Accounting Pronouncements

A discussion of recent accounting pronouncements is included in Note 2 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

§ Liquidity and Capital Resources

Liquidity

We fund the capital needs of our business through cash on hand, funds generated from operations, and amounts available under our unsecured revolving credit facility, which we refinanced in June 2014 by entering into an amended and restated five-year unsecured revolving credit facility in the principal amount of \$700 million (the amended and restated credit facility and the previous credit facility are referred to collectively as the “Credit Facility”). In addition, we issued \$150 million, \$125 million and \$75 million of our senior notes in December 2013, July 2014 and September 2014, respectively. At September 30, 2014 and December 31, 2013, we had \$292.7 million and \$279.1 million, respectively, of cash and cash equivalents, and working capital of \$72.4 million and \$174.4 million, respectively. Additionally, at September 30, 2014, we had remaining borrowing availability of \$324.0 million under our Credit Facility. We believe that, if necessary, we could obtain additional borrowings at prevailing market interest rates to fund our growth objectives. We further believe that current cash and cash equivalents, funds generated from operations and available borrowings will be sufficient to fund our operations, capital purchase requirements and strategic growth needs for the next twelve months. We believe that these resources, coupled with our ability, as needed, to obtain additional financing on favorable terms will be sufficient in the long term to fund our business as currently conducted.

We consider the majority of the operating earnings of certain non-U.S. subsidiaries to be indefinitely invested outside the U.S. No provision has been made for the payment of U.S. federal and state or international taxes that may result from future remittances of these undistributed earnings of non-U.S. subsidiaries. Changes to this position could have adverse tax consequences. A determination of the related tax liability that would be paid on these undistributed earnings if repatriated is not practicable. We manage our worldwide cash requirements considering available funds among all of our subsidiaries. Our foreign cash balances are generally available without restrictions to fund ordinary business operations outside the U.S. Of our total cash and cash equivalents at September 30, 2014, approximately \$282.6 million was held by our foreign subsidiaries and was subject to material repatriation tax effects. As of September 30, 2014, 56% of the cash and cash equivalents held by our non-U.S. subsidiaries was invested in money market funds restricted to U.S. government and agency securities and 44% was held as bank deposits. As of September 30, 2014, approximately 60% of the cash and cash equivalents held by our foreign subsidiaries was held in U.S. dollars.

Should we require more capital in the U.S. than is generated by our operations domestically, for example to fund significant discretionary activities, we could elect to repatriate future earnings from foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates or increased interest expense and other dilution of our earnings. We have borrowed funds domestically and continue to have the ability to borrow funds domestically at reasonable interest rates.

The following table presents additional key information concerning working capital:

For the Three Months Ended

| | September | September | March | December | September |
|--|-----------|-----------|-------|----------|-----------|
| | 30, | 30, | 31, | 31, | 30, |
| | 2014 | 2014 | 2014 | 2013 | 2013 |

| | | | | | |
|---------------------------|------|------|------|------|------|
| Days sales outstanding(1) | 39.2 | 40.8 | 42.8 | 39.9 | 41.9 |
| Inventory turns(2) | 1.8 | 1.8 | 1.8 | 1.9 | 1.7 |

(1) Days sales outstanding represents the average of the accounts receivable balances at the beginning and end of each quarter divided by revenue for that quarter, the result of which is then multiplied by 91.25 days.

(2) Inventory turns represent inventory-related cost of product revenue for the twelve months preceding each quarter-end divided by the inventory balance at the end of the quarter.

Sources and Uses of Cash

The following table presents cash provided (used):

| (dollars in thousands) | For the Nine Months Ended September 30, | | Dollar |
|---|--|------------|-------------|
| | 2014 | 2013 | 1 Change |
| Net cash provided by operating activities | \$ 208,543 | \$ 180,581 | \$ 27,962 |
| Net cash used by investing activities | (44,795) | (69,084) | 24,289 |
| Net used by financing activities | (145,777) | (69,396) | (76,381) |
| Net effect of changes in exchange rates on cash | (4,294) | (1,276) | (3,018) |
| Net increase in cash and cash equivalents | \$ 13,677 | \$ 40,825 | \$ (27,148) |

1 Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect \$0.9 million of net non-cash activities embedded in accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. See Note 1 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about this revision.

Operating Activities. Cash provided by operating activities was \$208.5 million for the nine months ended September 30, 2014, as compared to \$180.6 million for the same period of the prior year. The total of net income and net non-cash charges, excluding the impact of reclassifying the tax benefit from share-based compensation arrangements to a financing activity, was \$207.9 million for the nine months ended September 30, 2014, as compared to \$198.6 million for the same period of the prior year, resulting in an increase in operating cash flows of \$9.3 million driven primarily by an increase in net income, partly offset by the impact of deferred income taxes. The total of changes in operating assets and liabilities and the tax benefit from share-based compensation arrangements increased cash by \$0.6 million and decreased cash by \$18.1 million for the nine months ended September 30, 2014 and 2013, respectively, resulting in an incremental increase in cash of \$18.7 million.

The following table presents cash flows from changes in operating assets and liabilities and the tax benefit from share-based compensation arrangements:

| (dollars in thousands) | For the Nine Months Ended September 30, | | Dollar |
|------------------------|--|-------------|----------|
| | 2014 | 2013 | 1 Change |
| Accounts receivable | \$ (8,464) | \$ (12,795) | \$ 4,331 |
| Inventories | (12,638) | (10,216) | (2,422) |

| | | | |
|--|----------|-------------|-----------|
| Other assets | (3,375) | 4,717 | (8,092) |
| Accounts payable | 6,876 | 3,958 | 2,918 |
| Accrued liabilities | 16,216 | (335) | 16,551 |
| Deferred revenue | 11,566 | 4,050 | 7,516 |
| Tax benefit from share-based compensation arrangements | (9,581) | (7,438) | (2,143) |
| Total | \$ 600 | \$ (18,059) | \$ 18,659 |

1 Revisions were made to the condensed consolidated statement of cash flows for the nine months ended September 30, 2013 to correctly reflect \$0.9 million of non-cash activities embedded in accounts payable, accrued liabilities and inventory on the condensed consolidated balance sheets at September 30, 2013 and December 31, 2012. See Note 1 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about this revision.

The increase in the cash provided by accrued liabilities was due primarily to lower relative taxes paid relating to the 2013 tax year, as compared to the 2012 tax year, and higher personnel-related accruals at September 30, 2014, primarily resulting from improved business performance. The incremental cash provided by deferred revenue for the nine months ended September 30, 2014, as compared to the same period of the prior year was due primarily to sales under our Catalyst One introductory offer launched in the first quarter of 2014. Similarly, the incremental cash used by other assets during the nine months ended September 30, 2014, as compared to the same period of the prior year was due to the deferred cost of Catalyst instrument placements under our Catalyst One introductory offer.

We historically have experienced proportionally lower net cash flows from operating activities during the first quarter and proportionally higher cash flows from operating activities for the remainder of the year and for the annual period driven primarily by payments related to annual employee incentive programs in the first quarter following the year for which the bonuses were earned and the seasonality of vector-borne disease testing, which has historically resulted in significant increases in accounts receivable balances during the first quarter of the year.

Investing Activities. Cash used by investing activities was \$44.8 million for the nine months ended September 30, 2014, as compared to \$69.1 million for the same period of the prior year. The decrease in cash used by investing activities was due primarily to the completion of our headquarters facility expansion in August 2013.

Our total capital expenditure plan for 2014 is estimated to be approximately \$75 million, which includes investments in information technology infrastructure and software for internal use, capital investments in manufacturing equipment and investments in our reference laboratory equipment and facilities.

Financing Activities. Cash used by financing activities was \$145.8 million for the nine months ended September 30, 2014, as compared to \$69.4 million for the same period of the prior year. The increase in cash used to repurchase common stock and lower relative net borrowings under the Credit Facility was partly offset by \$200 million provided from the issuance of long-term debt during the nine months September 30, 2014.

Cash used to repurchase shares of our common stock increased by \$186.1 million during the nine months ended September 30, 2014, as compared to the same period of the prior year. From the inception of our share repurchase program in August 1999 to September 30, 2014, we have repurchased 52.8 million shares. During the nine months ended September 30, 2014, we purchased 3.7 million shares for an aggregate cost of \$469.0 million, as compared to purchases of 3.1 million shares for an aggregate cost of \$282.9 million during the nine months ended September 30, 2013. We believe that the repurchase of our common stock is a favorable means of returning value to our shareholders, and we also repurchase our stock to offset the dilutive effect of our share-based compensation programs. Repurchases of our common stock may vary depending upon the level of other investing activities and the share price. See Note 10 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information about our share repurchases.

As noted above, in June 2014, we refinanced our existing \$450 million Credit Facility and increased the principal amount thereunder to \$700 million. The Credit Facility matures on June 18, 2019 and requires no scheduled prepayments before that date. Although the Credit Facility does not mature until June 18, 2019, all amounts borrowed under the terms of the Credit Facility are reflected in the current liabilities section in the accompanying condensed consolidated balance sheets because the Credit Facility contains a subjective material adverse event clause, which allows the debt holders to call the loans under the Credit Facility if we fail to notify the syndicate of such an event. Applicable interest rates on borrowings under the Credit Facility generally range from 0.875 to 1.375 percentage points above the London interbank offered rate or the Canadian Dollar-denominated bankers' acceptance rate, based on our leverage ratio, or the prevailing prime rate plus a maximum spread of up to 0.375%, based on our leverage ratio.

Net borrowing and repayment activity under the Credit Facility resulted in incremental cash used, as compared to the same period of the prior year, of \$87.2 million during the nine months ended September 30, 2014. At September 30, 2014, we had \$375.0 million outstanding under the Credit Facility. The general availability of funds under the Credit Facility was further reduced by \$1.0 million for a letter of credit that was issued in connection with claims under our workers' compensation policy. The Credit Facility contains affirmative, negative and financial covenants customary for financings of this type. The negative covenants include restrictions on liens, indebtedness of subsidiaries of the Company, fundamental changes, investments, transactions with affiliates and certain restrictive agreements. The

financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Credit Facility. The obligations under the Credit Facility may be accelerated upon the occurrence of an event of default under the Credit Facility, which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974, the failure to pay specified indebtedness and a change of control default.

In December 2013, we issued and sold through a private placement an aggregate principal amount of \$150 million of senior notes consisting of \$75 million of 3.94% Series A Senior Notes due December 11, 2023 (the “2023 Notes”) and \$75 million of 4.04% Series B Senior Notes due December 11, 2025 (the “2025 Notes” and together with the 2023 Notes, the “December Notes”) under a Note Purchase Agreement among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (the “December 2013 Note Agreement”).

In July 2014, we issued and sold through a private placement an aggregate principal amount of \$125 million of senior notes consisting of \$75 million of 3.76% Series B Senior Notes due July 21, 2024 (the “2024 Notes”) and \$50 million of 3.32% Series A Senior Notes due July 21, 2021 (the “2021 Notes” and together with the 2024 Notes, the “Prudential Notes”) under a Note Purchase and Private Shelf Agreement among the Company, Prudential Investment Management, Inc. and the accredited institutional purchasers named therein (the “July 2014 Note Agreement”).

In September 2014, we issued and sold through a private placement an aggregate principal amount of \$75 million of 3.72% Senior Notes due September 4, 2026 (the “2026 Notes” and together with the Prudential Notes and the December Notes, the “Senior Notes”) under a Note Purchase Agreement dated as of July 22, 2014 among the Company, New York Life Insurance Company and the accredited institutional purchasers named therein (such agreement, together with July 2014 Note Agreement and December 2013 Note Agreement, the “Senior Note Agreements”).

The Senior Note Agreements contain affirmative, negative and financial covenants customary for agreements of this type. The negative covenants include restrictions on liens, indebtedness of our subsidiaries, priority indebtedness, fundamental changes, investments, transactions with affiliates, certain restrictive agreements and violations of laws and regulations. The financial covenant is a consolidated leverage ratio test that requires our ratio of debt to earnings before interest, taxes, depreciation, amortization and share-based compensation, as defined in the Senior Note Agreements, not to exceed 3.5-to-1. At September 30, 2014, we were in compliance with the covenants of the Senior Note Agreements.

Should we elect to prepay the Senior Notes, such aggregate prepayment will include the applicable make-whole amount(s), as defined within the applicable Senior Note Agreements. Additionally, in the event of a change in control of the Company or upon the disposition of certain assets of the Company the proceeds of which are not reinvested (as defined in the Senior Note Agreements), we may be required to prepay all or a portion of the Senior Notes. The obligations under the Senior Notes may be accelerated upon the occurrence of an event of default under the applicable Senior Note Agreement, each of which includes customary events of default including payment defaults, defaults in the performance of the affirmative, negative and financial covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to judgments, certain events related to employee pension benefit plans under the Employee Retirement Income Security Act of 1974 and the failure to pay specified indebtedness.

Other Commitments, Contingencies and Guarantees

Significant commitments, contingencies and guarantees at September 30, 2014 are consistent with those discussed in the section under the heading “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources” and in Note 14 to the consolidated financial statements in our 2013 Annual Report, with the exception of \$200 million of long-term debt issued during the nine months ended September 30, 2014. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information regarding our senior notes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting us, see the section under the heading “Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our 2013 Annual Report. As of the date of this Quarterly Report on Form 10-Q, there have been no material changes to the market risks described in our 2013 Annual Report.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures, as defined by the SEC in its Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures at September 30, 2014, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended September 30, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Due to the nature of our activities, we are at times subject to pending and threatened legal actions that arise out of the ordinary course of business. In the opinion of management, based in part upon advice of legal counsel, the disposition of any such currently pending matters is not expected to have a material effect on our results of operations, financial condition or cash flows. However, the results of legal actions cannot be predicted with certainty. Therefore, it is possible that our results of operations, financial condition or cash flows could be materially adversely affected in any particular period by the unfavorable resolution of one or more legal actions.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in “Part I, Item 1A. Risk Factors” in our 2013 Annual Report, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors previously disclosed in the 2013 Annual Report, except for the additional risk factor set forth below. The risks described in this Quarterly Report on Form 10-Q and in our 2013 Annual Report are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Uncertainties in Executing a Recently Announced All-Direct Sales Strategy in the U.S. Could Negatively Impact Our Results of Operations, and this New Strategy May Not Be Successful

On July 25, 2014, we announced our plan to transition to an all-direct sales strategy for our rapid assay test kits and instrument consumables (“kits and consumables”) in the U.S. effective January 1, 2015. Successfully executing this plan will require us to concurrently achieve a number of key objectives in a relatively short period of time, including, among other things, successfully recruiting, retaining and training additional personnel in key positions (such as sales, marketing and customer support) and developing or enhancing the necessary operational, logistics and systems

support for an all-direct sales strategy in the U.S. Implementation of the new strategy will require us to incur additional transitional cost and expense in 2014 and will result in the drawdown of distributor inventory in 2014 and potentially in early 2015. These transitional costs and expenses and inventory drawdown are expected to negatively affect our earnings during these periods. In addition, there can be no assurance that we will be wholly successful in our efforts, and if we are delayed or otherwise unable to effectively implement and support the new strategy, our results of operations may be negatively impacted. We also cannot assure you that the new strategy will result in growth of practice-level sales of our kits and consumables from historical levels.

In connection with executing this plan, we are not renewing our existing contracts with our key U.S. distribution partners after their expiration at the end of 2014. In October 2014, three of our previously exclusive U.S. distribution partners announced that they would begin carrying competitive products in the fourth quarter of 2014, before we have completed our transition to an all-direct sales strategy in the U.S. for our kits and consumables. We have historically sold significant amounts of our kits and consumables through our U.S. distribution partners, and the change in our existing relationships with these distribution partners and the transition of previously exclusive distributors to promoting and selling competitive products may adversely affect the retention of our customers for our kits and consumables and the sales and distribution of our products, which could have an adverse effect on our results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended September 30, 2014, we repurchased shares of common stock as described below:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------------------------------|----------------------------------|------------------------------|--|--|
| (a) | (b) | (c) | (d) | (d) |
| July 1 to July 31, 2014 | 280,063 | \$ 132.60 | 280,020 | 6,132,313 |
| August 1 to August 31, 2014 | 937,354 | 125.83 | 937,354 | 5,194,959 |
| September 1 to September 30, 2014 | 980,151 | 119.75 | 979,336 | 4,215,623 |
| Total | 2,197,568 | (2) \$ 123.98 | 2,196,710 | 4,215,623 |

(1)As of September 30, 2014, our Board of Directors had approved the repurchase of up to 57 million shares of our common stock in the open market or in negotiated transactions pursuant to the Company's share repurchase program. The program was approved and announced on August 13, 1999, and the maximum number of shares that may be purchased under the program was subsequently increased on October 4, 1999, November 16, 1999, July 21, 2000, October 20, 2003, October 12, 2004, October 12, 2005, February 14, 2007, February 13, 2008, February 10, 2010, October 12, 2011, May 7, 2013 and again on July 16, 2014, when the Board of Directors authorized the repurchase by the Company of up to an additional five million shares of our common stock. There is no specified expiration date for this repurchase program. There were no other repurchase programs outstanding during the three months ended September 30, 2014, and no repurchase programs expired during the period. Repurchases of 2,196,710 shares were made during the three months ended September 30, 2014 in transactions made pursuant to our repurchase program.

(2)During the three months ended September 30, 2014, we received 858 shares of our common stock that were surrendered by employees in payment for the minimum required withholding taxes due on the vesting of restricted stock units and settlement of deferred stock units. In the above table, these shares are included in columns (a) and (b), but excluded from columns (c) and (d). These shares do not reduce the number of shares that may yet be purchased under the repurchase program.

Item 6.Exhibits

| Exhibit No. | Description |
|-------------|--|
| 10.1 | Note Purchase and Private Shelf Agreement, dated as of July 21, 2014, among the Company, as issuer, Prudential Investment Management, Inc., Pruco Life Insurance Company, The Prudential Insurance Company of America, Prudential Investment Japan Co., Ltd., as investment manager, and Prudential Investment Management, Inc., as sub-adviser for The Gibraltar Life Insurance Co., Ltd., Prudential Arizona Reinsurance Universal Company, as grantor, and Prudential Investment Management, Inc., as investment manager for PAR U Hartford Life Insurance Comfort Trust, Prudential Private Placement Investors, L.P., as investment advisor, and Prudential Private Placement Investors, Inc., as general partner to each of, The Independent Order of Foresters, Zurich American Insurance Company, Globe Life and Accident Insurance Company, Family Heritage Life Insurance Company of America, MTL Insurance Company, The Lincoln National Life Insurance Company, William Penn Life Insurance Company of New York, Farmers Insurance Exchange and Mid Century Insurance Company, as purchasers (filed as Exhibit 99.1 to Form 8-K filed July 25, 2014, File No. 00-19271, and incorporated herein by reference). |
| 10.2 | Note Purchase Agreement, dated as of July 22, 2014, among the Company, as issuer, New York Life Insurance Company, and NYL Investors LLC, as investment manager for New York Life Insurance and Annuity Corporation and New York Life Insurance and Annuity Corporation Institutionally Owned Life Insurance Separate Account (BOLI 30C), as purchasers (filed as Exhibit 99.2 to Form 8-K filed July 25, 2014, File No. 00-19271, and incorporated herein by reference). |
| 31.1 | Certification of Principal Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
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| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |

101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB XBRL Taxonomy Extension Label Linkbase Document.
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

IDEXX LABORATORIES, INC.

/s/ Brian P. McKeon

Date: October 24, 2014 Brian P. McKeon
Executive Vice President, Chief Financial Officer
and Treasurer
(Duly Authorized Officer, Principal Financial Officer)

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