SYNERGETICS USA INC
Form 10-Q
June 07, 2011

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

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

For the quarterly period ended April 30, 2011

£ 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 001-10382

SYNERGETICS USA, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-5715943 (I.R.S. Employer Identification No.)
3845 Corporate Centre Drive O'Fallon, Missouri (Address of principal executive offices)	63368 (Zip Code)

(636) 939-5100
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether 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 R 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. (Check one):

Large Accelerated Filer	£	Accelerated Filer	£

Non-Accelerated Filer (Do not check if smaller reporting company)	£	Smaller Reporting Company	R

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

The number of shares outstanding of the issuer's common stock, $0.001 value per share, as of June 2, 2011 was 24,965,704 shares.

SYNERGETICS USA, INC.
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Part I — Financial Information
Item 1 — Unaudited Condensed Consolidated Financial Statements
Synergetics USA, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
As of April 30, 2011 (Unaudited) and July 31, 2010
(Dollars in thousands, except share data)

	April 30, 2011	July 31, 2010
Assets		
Current Assets		
Cash and cash equivalents	$16,991	$18,669
Accounts receivable, net of allowance for doubtful accounts of $310 and $282, respectively	9,361	9,056
Inventories	13,523	11,891
Prepaid expenses	1,156	792
Deferred income taxes	739	658
Total current assets	41,770	41,066
Property and equipment, net	8,686	8,044
Intangible and other assets		
Goodwill	10,690	10,690
Other intangible assets, net	11,922	12,353
Patents, net	1,041	870
Cash value of life insurance	72	72
Total assets	$74,181	$73,095
Liabilities and stockholders' equity		
Current Liabilities		
Current maturities of long-term debt	$1,206	$1,398
Current maturities of revenue bonds payable	--	116
Accounts payable	1,686	1,800
Accrued expenses	2,289	2,624
Income taxes payable	43	11
Deferred revenue	982	400
Total current liabilities	6,206	6,349
Long-Term Liabilities		
Long-term debt, less current maturities	--	939
Revenue bonds payable, less current maturities	--	1,612
Deferred revenue	18,061	18,630
Deferred income taxes	1,287	1,339
Total long-term liabilities	19,348	22,520
Total liabilities	25,554	28,869
Commitments and contingencies (Note 8)		
Stockholders' Equity		
Common stock at April 30, 2011 and July 31, 2010, $0.001 par value, 50,000,000 shares authorized; 24,969,508 and 24,772,155 shares issued and outstanding, respectively	25	25
Additional paid-in capital	25,492	24,905
Retained earnings	22,915	19,319
Accumulated other comprehensive income (loss):		
Foreign currency translation adjustment	195	(23)

Total stockholders’ equity	48,627	44,226
Total liabilities and stockholders’ equity	$74,181	$73,095

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Synergetics USA, Inc. and Subsidiaries
Consolidated Statements of Income
Three and Nine Months Ended April 30, 2011 and 2010
(Dollars in thousands, except share and per share data)

	Three Months Ended April 30, 2011	Three Months Ended April 30, 2010	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Net sales	$ 14,695	$ 13,859	$ 40,049	$ 39,020
Cost of sales	6,148	5,828	16,746	16,647
Gross profit	8,547	8,031	23,303	22,373
Operating expenses				
Research and development	882	886	2,587	2,320
Sales and marketing	2,771	2,896	8,528	9,200
General and administrative	2,427	2,204	6,854	6,286
	6,080	5,986	17,969	17,806
Operating income	2,467	2,045	5,334	4,567
Other income (expenses)				
Investment income	22	--	82	2
Interest expense	(37)	(113)	(182)	(412)
Settlement gain	--	2,398	--	2,398
Gain (Loss) on sale of product line	--	893	(99)	817
Miscellaneous	--	(5)	(11)	23
	(15)	3,173	(210)	2,828
Income before provision for income taxes	2,452	5,218	5,124	7,395
Provision for income taxes	809	1,909	1,528	2,667
Net income	$ 1,643	$ 3,309	$ 3,596	$ 4,728
Earnings per share:				
Basic	$ 0.07	$ 0.13	$ 0.14	$ 0.19
Diluted	$ 0.07	$ 0.13	$ 0.14	$ 0.19
Basic weighted average common shares outstanding	24,945,707	24,701,260	24,878,768	24,579,928
Diluted weighted average common shares outstanding	25,108,582	24,740,304	25,004,258	24,614,869

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Synergetics USA, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Nine Months Ended April 30, 2011 and 2010
(Dollars in thousands)

	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Cash Flows from Operating Activities		
Net income	$ 3,596	$ 4,728
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	822	784
Amortization	490	667
Provision for doubtful accounts receivable	15	(65)
Stock-based compensation	252	218
Deferred income taxes	(134)	(435)
Loss (gain) on sale of property and equipment	50	(15)
Loss (gain) on sale of product line	99	(817)
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(279)	(1,963)
Inventories	(1,564)	1,388
Prepaid expenses	(337)	(194)
(Decrease) increase in:		
Accounts payable	(135)	27
Accrued expenses	(346)	(979)
Income taxes payable	32	1,618
Deferred revenue	13	19,030
Net cash provided by operating activities	2,574	23,992
Cash Flows from Investing Activities		
Proceeds from the sale of equipment	11	15
Purchase of property and equipment	(1,525)	(594)
Acquisition of patents and other intangibles	(231)	(146)
Proceeds from sale of product line	--	1,336
Net cash used in (provided by) investing activities	(1,745)	611
Cash Flows from Financing Activities		
Excess of outstanding checks over bank balance	--	(75)
Net (repayments) on lines-of-credit	--	(5,035)
Principal payments on revenue bonds payable	(1,728)	(1,620)
Principal payments on long-term debt	(686)	(175)
Payment on debt incurred for acquisition of trademark	(445)	(420)
Tax benefit associated with the exercise of non-qualified stock options	125	--
Proceeds from the issuance of common stock	211	12
Net cash used in financing activities	(2,523)	(7,313)
Foreign exchange rate effect on cash and cash equivalents	16	8
Net (decrease) increase in cash and cash equivalents	(1,678)	17,298
Cash and cash equivalents		
Beginning	18,669	160

Ending	$ 16,991	$ 17,458

See Notes to Unaudited Condensed Consolidated Financial Statements.

Synergetics USA, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements
(Tabular information reflects dollars in thousands, except share and per share information)

Note 1. General

Nature of business: Synergetics USA, Inc. ("Synergetics USA" or the "Company") is a Delaware corporation incorporated on June 2, 2005, as a result of the reverse merger of Synergetics, Inc. ("Synergetics") and Valley Forge Scientific Corp. ("Valley Forge") and the subsequent reincorporation of Valley Forge (the predecessor to Synergetics USA) in Delaware. Synergetics USA is a medical device company. Through continuous improvement and development of our people, our mission is to design, manufacture and market innovative microsurgical devices, capital equipment, accessories and disposables of the highest quality in order to enable surgeons who perform microsurgery around the world to provide a better quality of life for their patients. The Company's primary focus is on the microsurgical disciplines of ophthalmology and neurosurgery. Our distribution channels include a combination of direct and independent sales organizations and important strategic alliances with market leaders. The Company is located in O'Fallon, Missouri and King of Prussia, Pennsylvania. During the ordinary course of its business, the Company grants unsecured credit to its domestic and international customers.

Basis of presentation: The unaudited condensed consolidated financial statements include the accounts of Synergetics USA, Inc., and its wholly owned subsidiaries: Synergetics, Synergetics Development Company, LLC, Synergetics Delaware, Inc. and Synergetics IP, Inc. All significant intercompany accounts and transactions have been eliminated. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended April 30, 2011, are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2011. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended July 31, 2010, and notes thereto filed with the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on October 12, 2010 (the "Annual Report").

Note 2. Comprehensive Income

Comprehensive income was $1,829,000 and $3,814,000 for the three and nine months ended April 30, 2011. The Company's only component of other comprehensive income is the foreign currency translation adjustment.

Note 3. Summary of Significant Accounting Policies

Deferred revenue: During the second quarter of fiscal 2011, the Company received a payment from Codman & Shurtleff, Inc. ("Codman"), a marketing partner, to establish exclusivity on certain generator products and accessories. Revenue from the payment has been deferred and is being amortized over the expected term of the agreement. The Company recognized $135,000 and $199,000, respectively, of this deferred revenue for the three and nine months ended April 30, 2011. In addition, included in deferred revenue is an amount the Company received pursuant to a Confidential Settlement and License Agreement with Alcon, Inc. ("Alcon"). This payment was accounted for as an up-front licensing fee. Recognition of the revenue pursuant to this agreement has been deferred and is being recognized over a period of up to fifteen years based upon estimated shipments to Alcon under a related Supply Agreement executed pursuant to the settlement. The Company recognized $157,000 and $388,000, respectively, of this deferred revenue as the estimate of these shipments has been revised for the three and nine months ended April

30, 2011.

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The Company's significant accounting policies are disclosed in the Annual Report. In the first nine months of fiscal 2011, no significant accounting policies were changed other than the deferred revenue policy discussed above.

Note 4. Marketing Partner Agreements

The Company sells most of its electrosurgery generators and neurosurgery instruments and accessories to two U.S. based, global marketing partners as described below:

Codman

In the neurosurgical market, the bipolar electrosurgical system manufactured by Valley Forge prior to the merger has been sold for over 25 years through a series of distribution agreements with Codman, an affiliate of Johnson & Johnson. On April 2, 2009, the Company executed a new, three-year distribution agreement with Codman for the continued distribution by Codman of certain bipolar generators and related disposables and accessories effective January 1, 2009. In addition, the Company entered into a new, three-year license agreement, which provides for the continued licensing of the Company's Malis® trademark to Codman for use with certain Codman products, including those covered by the distribution agreement. Both agreements expire on December 31, 2011 and may renew for an additional three year period. In December 2010, Codman elected to exercise its option of exclusive distribution with respect to the bipolar generators and related disposables and accessories.

On November 16, 2009, the Company announced the signing of an addendum to its three-year agreement with Codman. Under the terms of the revised agreement, Codman has the exclusive right to market and distribute the Company's Malis® SpetzlerTM branded disposable forceps produced by Synergetics. Codman began distribution of the disposable bipolar forceps on December 1, 2009, domestically and February 1, 2010, internationally.

Total sales to Codman and its respective percent of the Company's net sales for the three and nine months ended April 30, 2011 and 2010, including the historical sales of generators, accessories and disposable cord tubing that the Company has supplied in the past, as well as the disposable bipolar forceps sales resulting from the addendum to the existing distribution agreement and revenue recognized from the exclusivity payment, were as follows (dollars in thousands):

	Three Months Ended April 30, 2011	Three Months Ended April 30, 2010	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Net Sales	$ 2,892	$ 2,304	$ 7,419	$ 4,777
Percent of net sales	19.7 %	16.6 %	18.5 %	12.2 %

Stryker Corporation ("Stryker")

The Company supplies a lesion generator used for minimally invasive pain treatment to Stryker pursuant to a supply and distribution agreement dated as of October 25, 2004. The original term of the agreement was for slightly over five years, commencing on November 11, 2004 and ending on December 31, 2009. On August 1, 2007, the Company negotiated a one-year extension to the agreement through December 31, 2010 and increased the minimum purchase obligation to 300 units per year for the remaining contract period. The Company has negotiated a four-year extension to the agreement through December 31, 2015.

On March 31, 2010, the Company entered into an additional strategic agreement with Stryker including the sale of accounts receivable, open sales orders, inventory and certain intellectual property related to the Omni® ultrasonic aspirator product line. For fiscal year 2010, the gain from the sale of the Omni® product line to Stryker was

$817,000. In the second quarter of fiscal 2011, the Company recorded an additional $99,000 loss on the sale of this product line, as certain receivables were deemed uncollectible. In addition, the agreement provides for the Company to supply disposable ultrasonic instrument tips and certain other consumable products used in conjunction with the ultrasonic aspirator console and handpieces and to pursue certain development projects for new products associated with Stryker’s ultrasonic aspirator. This agreement expires on March 31, 2014.

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Total sales to Stryker and its respective percent of the Company's net sales for the three and nine months ended April 30, 2011 and 2010, including the historical sales of pain control generators and accessories that the Company has supplied in the past, as well as the disposable ultrasonic instrument tips sales and certain other consumable products resulting from the new agreements, were as follows (dollars in thousands):

	Three Months Ended April 30, 2011	Three Months Ended April 30, 2010	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Net Sales	$ 1,943	$ 1,640	$ 5,299	$ 2,898
Percent of net sales	13.2 %	11.8 %	13.2 %	7.4 %

No other customer comprises more than 10 percent of sales in any given quarter.

Note 5. Stock-Based Compensation

Stock Option Plans

The following table provides information about stock-based awards outstanding at April 30, 2011:

	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Options outstanding beginning of period	576,695	$2.08	$1.71
For the period August 1, 2010 through April 30, 2011			
Granted	108,751	$4.43	$3.56
Forfeited	(27,000)	$3.21	$2.71
Exercised	(141,417)	$1.49	$1.29
Options outstanding, end of period	517,029	$2.68	$2.16
Options exercisable, end of period	354,028	$2.51	$2.02

During the second quarter of fiscal 2011, there were 40,000 options granted to the Company's independent directors, which vest pro-ratably on a quarterly basis over the next year of service. Each independent director receives an option to purchase 10,000 shares of the Company's Common Stock each year in which he or she is elected, appointed, or re-elected to serve as a director pursuant to the Amended and Restated 2005 Non-Employee Directors' Stock Option Plan. The Company recorded $35,000 and $47,000, respectively, of compensation expense for each of the three and nine months ended April 30, 2011 related to these options. In addition, the Company recorded $0 and $18,000, respectively, of compensation expense for the three and nine months ended April 30, 2011, for previously granted options.

During the second quarter of fiscal 2011, there were options to purchase 68,751 shares of Common Stock granted to the officers of the Company. These options were granted in conjunction with the Company's annual review of compensation as of August 1, 2010 and vest pro-ratably on a quarterly basis over the next five years of service. The Company recorded $12,000 and $16,000, respectively, of compensation expense for the three and nine months ended April 30, 2011 related to these options. In addition, the Company recorded $8,000 and $24,000, respectively, of compensation expense for the three and nine months ended April 30, 2011 for previously granted options.

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The fair value of all options granted during the second fiscal quarter was determined at the date of the grant using the Black-Scholes options-pricing model and the following assumptions:

Expected average risk-free interest rate	3.30	%
Expected average life (in years)	10	
Expected volatility	75.38	%
Expected dividend yield	0.0	%

The expected average risk-free rate is based on the 10 year U.S. treasury yield curve in December of 2010. The expected average life represents the period of time that the options granted are expected to be outstanding giving consideration to the vesting schedules, historical exercises and forfeiture patterns. Expected volatility is based on historical volatilities of the Company's Common Stock. The expected dividend yield is based on historical information and management's plan.

The intrinsic value of in-the-money stock options outstanding was $1.4 million and $24,000 at April 30, 2011 and 2010, respectively. The intrinsic value of in-the-money exercisable stock options was $1.0 million and $296,000 at April 30, 2011 and 2010, respectively.

The Company expects to issue new shares as options are exercised. As of April 30, 2011, the future compensation cost expected to be recognized for currently outstanding stock options is approximately $55,000 for the remainder of fiscal 2011, $130,000 in fiscal 2012, $68,000 in fiscal 2013, $68,000 in fiscal 2014, $56,000 in fiscal 2015 and $20,000 in 2016.

Restricted Stock Plans

Under our Amended and Restated Synergetics USA, Inc. 2001 Stock Plan ("2001 Plan"), Common Stock may be granted at no cost to certain employees and consultants of the Company. Certain plan participants are entitled to cash dividends and voting rights for their respective shares. Restrictions limit the sale or transfer of these shares during a vesting period whereby the restrictions lapse either pro-ratably over a three to five-year vesting period or at the end of the fifth year. These shares also vest upon a change of control event. Upon issuance of stock under the 2001 Plan, unearned compensation equivalent to the market value at the date of the grant is charged to stockholders' equity and subsequently amortized to expense over the applicable restriction period. As of April 30, 2011, there was approximately $452,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2001 Plan. The cost is expected to be recognized over a weighted average period of three to five years. The following table provides information about restricted stock grants during the nine-month period ended April 30, 2011:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance as of July 31, 2010	286,961	$2.04
Granted	43,846	$4.43
Forfeited	--	--
Balance as of April 30, 2011	330,807	$2.36

Note 6. Fair Value Information

Fair value is an exit price that represents the amount that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants.

The Company has no financial assets which are required to be measured at fair value on a recurring basis. Non-financial assets such as goodwill, intangible assets and property, plant and equipment are measured at fair value when there is an indicator of impairment and recorded at fair value only when impairment is recognized. No impairment indicators existed as of April 30, 2011.

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The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value because of the short maturity of these items. The carrying amount of the Company's notes payable is estimated to approximate fair value because the variable interest rates or the fixed interest rates are based on estimated current rates offered to the Company for debt with similar terms and maturities.

Note 7. Supplemental Balance Sheet Information

Accounts Receivable and Allowance for Doubtful Accounts: The Company maintains allowances for doubtful accounts for estimated probable losses resulting from the inability of the Company's customers to make required payments. The Company continues to assess the adequacy of the reserves for doubtful accounts based on the financial condition of the Company's customers and other external factors that may impact collectability. The majority of the Company's accounts receivable are due from trade customers, primarily in the hospital or ambulatory surgery center environment. Credit is extended based on an evaluation of the customers' financial condition and generally, collateral is not required. Payment terms vary and accounts receivable are stated in the Condensed, Consolidated Financial Statements at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding for longer than the payment terms are considered past due. The Company considers a number of factors in determining the allowance for doubtful accounts, including the length of time trade accounts receivable are past due, the customers' current ability to pay their obligations to the Company, the Company's previous loss history, and the condition of the general economy and the medical industry as a whole. The Company writes off accounts receivable when they become uncollectible. The Company's accounts receivable balance at April 30, 2011 reflects an allowance for doubtful accounts of $310,000 and at July 31, 2010 of $282,000.

Inventories: Inventories as of April 30, 2011 and July 31, 2010 were as follows (dollars in thousands):

	April 30, 2011	July 31, 2010
Raw material and component parts	$5,962	$5,225
Work in progress	2,611	2,050
Finished goods	4,950	4,616
	$13,523	$11,891

Property and Equipment: Property and equipment as of April 30, 2011 and July 31, 2010 were as follows (dollars in thousands):

	April 30, 2011	July 31, 2010
Land	$730	$730
Building and improvements	5,965	5,929
Machinery and equipment	6,858	6,136
Furniture and fixtures	729	736
Software	363	363
Construction in progress	722	232
	15,367	14,126
Less accumulated depreciation	6,681	6,082
	$8,686	$8,044

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Other Intangible Assets: Information regarding the Company's other intangible assets as of April 30, 2011 and July 31, 2010 is as follows (dollars in thousands):

	Gross Carrying Value	Accumulated Amortization	Net
		April 30, 2011	
Proprietary know-how	$4,057	$ 1,730	$2,327
Trademark	5,923	--	5,923
Licensing agreement	5,834	2,162	3,672
Patents	1,617	576	1,041
	$17,431	$ 4,468	$12,963
		July 31, 2010	
Proprietary know-how	$4,057	$ 1,544	$2,513
Trademark	5,923	--	5,923
Licensing agreement	5,834	1,917	3,917
Patents	1,387	517	870
	$17,201	$ 3,978	$13,223

Goodwill of $10,660,000 and proprietary know-how of $4,057,000 are a result of the reverse merger transaction completed on September 21, 2005.

The Company did not incur costs to renew or extend the term of acquired intangible assets during the period ended April 30, 2011. Estimated amortization expense on other intangibles for the remaining three months of the fiscal year ending July 31, 2011, and the next four years thereafter is as follows (dollars in thousands):

	Amount
Fiscal Year 2011 (remaining 3 months)	$147
Fiscal Year 2012	587
Fiscal Year 2013	618
Fiscal Year 2014	617
Fiscal Year 2015	617

Amortization expense for the three and nine months ended April 30, 2011 was $147,000 and $490,000, respectively.

Pledged assets; short and long-term debt (excluding revenue bonds payable): Short-term debt as of April 30, 2011 and July 31, 2010, consisted of the following:

Revolving Credit Facility: The Company has a credit facility with a bank which allows for borrowings of up to $9.5 million (collateral available on April 30, 2011 permits borrowings up to $7.3 million) with an interest rate based on either the one-, two- or three-month LIBOR plus 2.0 percent and adjusting each quarter based upon our leverage ratio. As of April 30, 2011, interest under the facility is charged at 2.21 percent. The unused portion of the facility is charged at a rate of 0.20 percent. There were no borrowings under this facility at April 30, 2011. Outstanding amounts are collateralized by the Company's domestic receivables and inventory. This credit facility was amended on November 30, 2010, to extend the termination date through November 30, 2011.

The facility has two financial covenants: a maximum leverage ratio of 3.75 times and a minimum fixed charge coverage ratio of 1.1 times. As of April 30, 2011, the leverage ratio was 1.02 times and the minimum fixed charge coverage ratio was 3.17 times. Collateral availability under the line as of April 30, 2011, was approximately $7.3 million. The facility restricts the payment of dividends if, following the distribution, the fixed charge coverage ratio would fall below the required minimum.

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Non-U.S. Receivables Revolving Credit Facility: The Company had a non-U.S. receivables credit facility with a bank which allowed for borrowings of up to $1.75 million with an interest rate based upon LIBOR plus 3.0 percent. Pursuant to the terms of this facility, under no circumstances shall the rate be less than 3.5 percent per annum. The facility charged an administrative fee of 1.0 percent. Outstanding amounts were collateralized by the Company's non-U.S. receivables. This credit facility had no financial covenants or outstanding balance when it was terminated on November 30, 2010.

Equipment Line of Credit: Under this credit facility, the Company may borrow up to $1.0 million, with interest at one-month LIBOR plus 3.0 percent. Pursuant to the terms of the equipment line of credit, under no circumstances shall the rate be less than 3.5 percent per annum. The unused portion of the facility is not charged a fee. There were no borrowings under this facility at April 30, 2011. The equipment line of credit was amended on November 30, 2010, to extend the maturity date to November 30, 2011.

Long-term debt as of April 30, 2011 and July 31, 2010 consisted of the following (dollars in thousands):

	April 30, 2011	July 31, 2010
Note payable to the estate of the late Dr. Leonard I. Malis, due in quarterly installments of $159,904 which includes interest at an imputed rate of 6.0 percent; remaining balance of $480,000 including the effects of imputing interest, due December 2011, collateralized by the Malis® trademark	$466	$911
Settlement obligation to Iridex Corporation ("Iridex"), due in annual installments of $800,000 which includes interest at an imputed rate of 8.0 percent; remaining balance of $800,000 including the effects of imputing interest, due April 15, 2012	740	1,426
Total	$1,206	$2,337
Less: current maturities	1,206	1,398
Long-term portion	$--	$939

Deferred Revenue: Deferred revenue as of April 30, 2011 and July 31, 2010, consisted of the following (dollars in thousands):

	April 30, 2011	July 31, 2010
Deferred revenue - Alcon Settlement	$18,642	$19,030
Deferred revenue – Codman Exclusivity	401	--
Total	$19,043	$19,030
Less: Short-term	982	400
Long-term portion	$18,061	$18,630

Note 8. Commitments and Contingencies

Effective January 29, 2009, the Company's Board of Directors appointed David M. Hable to serve as President and Chief Executive Officer ("CEO"). Also on that date, the Company entered into a change in control agreement with Mr. Hable. On December 9, 2009, the Company entered into a change in control agreement with each of its Chief Operating Officer and Chief Scientific Officer, which agreements were contemplated in conjunction with the Company's annual review of compensation and therefore, the agreements were made effective with other compensation changes as of August 1, 2009. On October 12, 2010, the Company entered into a change of control agreement with its Chief Financial Officer ("CFO"), which agreement was contemplated in conjunction with the Company's annual review of compensation; therefore, the agreement was made effective with other compensation changes as of August 1, 2010. On March 3, 2011, the Company entered into a change of control agreement with each of its Vice President of Domestic Sales and Vice President of International Sales and Marketing, which agreements were contemplated in conjunction with the Company's annual review of compensation; therefore, the agreements were made effective with other compensation changes as of August 1, 2010. The change in control agreements with its executive officers, Vice President of Domestic Sales and Vice President of International Sales and Marketing each provide that if employment is terminated within one year following a change in control for cause or disability (as each term is defined in the change in control agreement), as a result of the officer's death, or by the officer other than as an involuntary termination (as defined in the change in control agreement), the Company shall pay the officer all compensation earned or accrued through his or her employment termination date, including (i) base salary; (ii) reimbursement for reasonable and necessary expenses; (iii) vacation pay; (iv) bonuses and incentive compensation; and (v) all other amounts to which they are entitled under any compensation or benefit plan of the Company ("Standard Compensation Due").

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If the officer's employment is terminated within one year following a change in control without cause and for any reason other than death or disability, including an involuntary termination, and provided the officer enters into a separation agreement within 30 days of his or her employment termination, he or she shall receive the following: (i) all Standard Compensation Due and any amount payable as of the termination date under the Company's objectives-based incentive plan, the sum of which shall be paid in a lump sum immediately upon such termination; and (ii) an amount equal to one times his or her annual base salary at the rate in effect immediately prior to the change in control, to be paid in 12 equal monthly installments beginning in the month following his or her employment termination. Furthermore, all of the officer's awards of shares or options shall immediately vest and be exercisable for one year after the date of his or her employment termination.

Various claims, incidental to the ordinary course of business, are pending against the Company. In the opinion of management, after consultation with legal counsel, resolution of these matters is not expected to have a material effect on the accompanying financial statements.

The Company is subject to regulatory requirements throughout the world. In the normal course of business, these regulatory agencies may require companies in the medical device industry to change their products or operating procedures, which could affect the Company. The Company regularly incurs expenses to comply with these regulations and may be required to incur additional expenses. Management is not able to estimate any additional expenditures outside the normal course of operations which will be incurred by the Company in future periods in order to comply with these regulations.

Note 9. Enterprise-wide Sales Information

Enterprise-wide sales information for the three and nine months ended April 30, 2011 and 2010, respectively, consisted of the following (dollars in thousands):

	Three Months Ended April 30, 2011	Three Months Ended April 30, 2010	Nine Months Ended April 30, 2011	Nine Months Ended April 30, 2010
Net Sales				
Ophthalmic	$ 9,226	$ 7,776	$ 25,038	$ 23,100
Neurosurgery - Direct	339	2,038	1,383	7,767
Marketing Partners (Codman, Stryker)	2,256	1,818	6,268	2,280
Total Neurosurgery	2,595	3,856	7,651	10,047
OEM (Codman, Stryker, Iridex)	2,840	2,195	7,289	5,776
Other	34	32	71	97
Total	$ 14,695	$ 13,859	$ 40,049	$ 39,020
Net Sales				
Domestic	$ 9,975	$ 9,408	$ 27,929	$ 26,648
International	4,720	4,451	12,120	12,372
	$ 14,695	$ 13,859	$ 40,049	$ 39,020

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Note 10. Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Update ("ASU") No. 2010-06, "Improving Disclosures about Fair Value Measurements," which amends Accounting Standards Codification 820, "Fair Value Measurements and Disclosures." This ASU requires disclosures of transfers into and out of Levels 1 and 2, more detailed roll forward reconciliations of Level 3 recurring fair value measurement on a gross basis, fair value information by class of assets and liabilities and descriptions of valuation techniques and inputs for Level 2 and 3 measurements. The effective date for the roll forward reconciliations is the first quarter of fiscal 2012. The Company does not believe the adoption of this ASU will have a material effect on its consolidated financial statements.

We have reviewed all other recently issued, but not yet effective, accounting pronouncements and do not believe any such pronouncements will have a material impact on our financial statements.

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

Overview

Synergetics USA, Inc. is a leading supplier of precision microsurgical devices. The Company's primary focus is on the microsurgical disciplines of ophthalmology and neurosurgery. Our distribution channels include a combination of direct and independent sales organizations and important strategic alliances with market leaders. The Company's product lines focus upon precision engineered, microsurgical devices and the delivery of various energy modalities for the performance of minimally invasive microsurgery, including: (i) laser energy, (ii) ultrasonic energy, (iii) radio frequency energy for electrosurgery and lesion generation and (iv) visible light energy for illumination, and where applicable, simultaneous infusion (irrigation) of fluids into the operative field. Enterprise-wide sales information is included in Note 9 to the unaudited condensed consolidated financial statements.

The Company is a Delaware corporation incorporated on June 2, 2005, as a result of the reverse merger of Synergetics, Inc. and Valley Forge Scientific Corp. Synergetics was founded in 1991. Valley Forge was incorporated in 1980 and became a publicly-held company in November 1989. Prior to the reverse merger of Synergetics and Valley Forge, Valley Forge's common stock was listed on The NASDAQ Small Cap Market (now known as The NASDAQ Capital Market) and the Boston Stock Exchange under the ticker symbol "VLFG." On September 21, 2005, Synergetics Acquisition Corporation, a wholly owned Missouri subsidiary of Valley Forge, merged with and into Synergetics, and Synergetics thereby became a wholly owned subsidiary of Valley Forge. On September 22, 2005, Valley Forge reincorporated from a Pennsylvania corporation to a Delaware corporation and changed its name to Synergetics USA, Inc. Upon consummation of the merger, the Company's securities began trading on The NASDAQ Capital Market under the ticker symbol "SURG," and its shares were voluntarily delisted from the Boston Stock Exchange.

Recent Developments

We had several developments in fiscal 2010 and fiscal 2011 that we expect will contribute to the growth of our business in the foreseeable future.

On April 1, 2010, the Company announced the closing of a definitive agreement with Stryker in conjunction with the acquisition by Stryker of certain assets from Mutoh Co., Ltd. and its affiliates, used to produce the Sonopet Ultrasonic Aspirator control consoles and handpieces (previously marketed under the Omni® brand by Synergetics in the U.S., Canada and several other countries). The agreement included the sale of accounts receivable, open sales orders, inventory and certain intellectual property related to the Omni® product line. The gain from the sale of the Omni®

product line to Stryker was $817,000 in fiscal 2010. In the second quarter of fiscal 2011, the Company recorded a $99,000 loss on the sale of this product line, as certain receivables were deemed to be uncollectible. In addition, the agreement provides for the Company to supply disposable ultrasonic instrument tips and certain other consumable products used in conjunction with the Sonopet/Omni® ultrasonic aspirator console and handpieces, and pursue certain development projects for new products associated with Stryker's ultrasonic aspirator products. The Company has negotiated a four-year extension to the agreement with Stryker through December 31, 2015. The Stryker relationship has been proceeding well and is meeting the Company's expectations for unit and dollar sales volumes.

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On November 16, 2009, the Company announced the signing of an addendum to its three-year agreement (effective as of January 1, 2009) with Codman. Under the terms of the revised agreement, Codman has the exclusive right to market and distribute the Company's Malis® branded disposable bipolar forceps. Codman began the domestic distribution of the disposable bipolar forceps on December 1, 2009 and the international distribution on February 1, 2010. The Codman relationship has been proceeding well and is meeting the Company's expectations for unit and dollar sales volumes.

Contribution margins for the products supplied to Codman and Stryker have increased, as anticipated, primarily due to the elimination of commercial expenses associated with the distribution of these products. However, sales and gross profit for these products have decreased, as the transfer prices to Codman and Stryker are lower than the previous average direct selling prices.

On April 27, 2010, the Company announced that it had entered into a Settlement and License Agreement with Alcon pursuant to which Alcon agreed to pay the Company $32.0 million, and the Company agreed to produce certain products for distribution by Alcon. The net proceeds to the Company were $21.4 million after contingency payments to attorneys. The Company recognized a gain from this agreement of $2.4 million in the third fiscal quarter of 2010. The remaining $19.0 million has been accounted for as deferred revenue on the balance sheet. As units are shipped to Alcon under a Supply Agreement entered pursuant to the settlement, the Company will be paid an incremental transfer price. In addition, the Company will recognize a portion of the deferred revenue as the estimate of these shipments to Alcon over a period of up to fifteen years is revised. The Company recognized $388,000 of this deferred revenue during the first nine months of fiscal 2011. Shipments to Alcon of the first of two products covered by the agreement are expected to begin in the first quarter of fiscal 2012.

On October 26, 2010, the Company announced record sales leads generated from the presentation of recently released ophthalmic products at the 2010 Annual Meeting of the American Academy of Ophthalmology.

On November 30, 2010, the Company extended its revolving credit facility and its equipment line of credit through November 30, 2011.

On December 9, 2010, the Company announced that it signed a product development and consulting agreement with Retinal Solutions, LLC located in Michigan.

On December 22, 2010, Codman elected to exercise its option of exclusive distribution with respect to the bipolar generators and related disposables and accessories.

On February 16, 2011, the Company retired the debt on its O'Fallon, Missouri facility.

On March 10, 2011, the Company reported that it had begun selling the VersaPACKTM for use in the vitreoretinal operating room. The launch of this product allows the Company to compete in an estimated $277 million segment of the vitreoretinal market in which we previously were unable to compete.

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Summary of Financial Information

The following tables present net sales by category and our results of operations (dollars in thousands):

NET SALES BY CATEGORY

	Three Months Ended					
	April 30, 2011	Mix		April 30, 2010	Mix	
Ophthalmology	$9,226	62.8	%	$7,776	56.1	%
Direct Neurosurgery	339	2.3	%	2,038	14.7	%
Marketing Partners (1)	2,256	15.4	%	1,818	13.1	%
Total Neurosurgery	2,595	17.7	%	3,856	27.8	%
Original Equipment Manufacturers (“OEM”) (2)	2,840	19.3	%	2,195	15.9	%
Other	34	0.2	%	32	0.2	%
Total	$14,695			$13,859		

	Nine Months Ended					
	April 30, 2011	Mix		April 30, 2010	Mix	
Ophthalmology	$25,038	62.5	%	$23,100	59.2	%
Direct Neurosurgery	1,383	3.4	%	7,767	19.9	%
Marketing Partners (1)	6,268	15.7	%	2,280	5.8	%
Total Neurosurgery	7,651	19.1	%	10,047	25.7	%
OEM	7,289	18.2	%	5,776	14.8	%
Other	71	0.2	%	97	0.3	%
Total	$40,049			$39,020		

(1) Marketing partners’ sales include disposable bipolar forceps, disposable ultrasonic instrument tips and accessories which were previously sold by our direct neurosurgery sales force and our distribution partners. These products have been transitioned to our marketing partners.
(2) Revenues from OEM represent sales of electrosurgical and pain control generators, related accessories, certain laser probes and deferred revenue to Codman, Stryker, Iridex and Alcon.

The increase in sales for the third quarter of fiscal 2011 compared with the third quarter of fiscal 2010 was primarily due to an increase of $1.5 million in ophthalmic sales and a $645,000 increase in OEM sales (including $292,000 of deferred revenue recognized), partially offset by a $1.3 million decrease in our neurosurgery sales due to the transition of the majority of our neurosurgery product sales to our marketing partners. In the third quarter of fiscal 2010, the Company sold $187,000 of Omni® capital equipment that was previously included in our direct neurosurgery sales and which the Company no longer sells. Overall sales of capital equipment in the third quarter of fiscal 2011, including the sales of Omni® capital equipment, declined by $707,000, or 25.1 percent, compared with the third quarter of fiscal 2010. However, the sales of our disposable products grew $1.3 million, or 11.8 percent, in the third quarter of fiscal 2011 as compared to the third quarter fiscal 2010.

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The increase in sales for the first nine months of fiscal 2011 compared with the first nine months of fiscal 2010 was primarily due to a $1.9 million increase in ophthalmology sales and a $1.5 million increase in OEM sales (including $587,000 of deferred revenue recognized), partially offset by a $2.4 million decrease in total neurosurgery sales due to the transition of the majority of our neurosurgery product sales to our marketing partners. In the first nine months of fiscal 2010, the Company sold $1.1 million of Omni® capital equipment that was previously included in our direct neurosurgery sales and which the Company no longer sells. Overall sales of our capital equipment in the first nine months of fiscal 2011, including the sales of Omni® capital equipment, declined by $2.2 million, or 23.9 percent, compared with the first nine months of fiscal 2010. However, the sales of our disposable products grew $2.7 million, or 9.1 percent, in the first nine months of fiscal 2011 as compared to the first nine months of fiscal 2010.

RESULTS OF OPERATIONS
(Dollars in Thousands)

	Three Months Ended		
	April 30, 2011	April 30, 2010(2)	Increase (Decrease)
Net Sales	$14,695	$13,859	6.0 %
Gross Profit	8,547	8,031	6.4 %
Gross Profit Margin %	58.2 %	57.9 %	0.5 %
Commercial Expenses			
Sales and Marketing	2,771	2,896	(4.3 %)
General and Administrative	2,427	2,204	10.1 %
Research and Development	882	886	(0.5 %)
Operating Income	2,467	2,045	20.6 %
Operating Margin	16.8 %	14.8 %	13.5 %
EBITDA (1)	2,899	5,815	(50.1 %)
Net Income	$1,643	$3,309	(50.3 %)
Earnings per share	$0.07	$0.13	(46.2 %)
Return on equity (1)	3.4 %	8.0 %	(57.5 %)
Return on assets (1)	2.2 %	5.2 %	(57.7 %)

	Nine Months Ended		
	April 30, 2011	April 30, 2010(2)	Increase (Decrease)
Net Sales	$40,049	$39,020	2.6 %
Gross Profit	23,303	22,373	4.2 %
Gross Profit Margin %	58.2 %	57.3 %	1.6 %
Commercial Expenses			
Sales and Marketing	8,528	9,200	(7.3 %)
General and Administrative	6,854	6,286	9.0 %
Research and Development	2,587	2,320	11.5 %
Operating Income	5,334	4,567	16.8 %
Operating Margin	13.3 %	11.7 %	13.7 %
EBITDA (1)	6,618	9,258	(28.5 %)
Net Income	$3,596	$4,728	(23.9 %)
Earnings per share	$0.14	$0.19	(26.3 %)
Return on equity (1)	7.8 %	11.8 %	(33.9 %)
Return on assets (1)	5.1 %	8.3 %	(38.6 %)

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(1) EBITDA, return on equity and return on assets are not financial measures recognized by U.S. GAAP. EBITDA is defined as income before net interest expense, income taxes, depreciation and amortization. Return on equity is defined as net income divided by average equity. Return on assets is defined as net income plus interest expense divided by average assets. See disclosure following regarding the use of non-GAAP financial measures.

(2) In the three and nine months ended April 30, 2010, the Company experienced two one-time items:

(a) gain from sale of product line to Stryker resulted in income of $893,000, net income of $566,000 and earnings per share of $0.02 and (b) settlement proceeds from Alcon resulted in income of $2.4 million, net income of $1.5 million and earnings per share of $0.06.

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Reconciliation of Non-GAAP Financial Measures

	Three Months Ended (Dollars in Thousands)		Nine Months Ended (Dollars in Thousands)	
	April 30, 2011	April 30, 2010	April 30, 2011	April 30, 2010
EDITDA Reconciliation				
Net Income	$1,643	$3,309	$3,596	$4,728
Interest	37	113	182	412
Income taxes	809	1,909	1,528	2,667
Depreciation and amortization	410	484	1,312	1,451
EBITDA	$2,899	$5,815		