

NATUS MEDICAL INC  
Form 10-Q  
August 08, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June, 30, 2014**

.. **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: 000-33001**

**NATUS MEDICAL INCORPORATED**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction**  
**of incorporation or organization)**

**77-0154833**  
**(I.R.S. Employer**  
**Identification No.)**

**1501 Industrial Road, San Carlos, CA 94070**

**(Address of principal executive offices) (Zip Code)**

**(650) 802-0400**

**(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 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. (Check one):

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

The number of issued and outstanding shares of the registrant's Common Stock, \$0.001 par value, as of August 1, 2014 was 32,311,466.

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**NATUS MEDICAL INCORPORATED**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****NATUS MEDICAL INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)****(in thousands, except share and per share amounts)**

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 56,018	\$ 56,106
Accounts receivable, net of allowance for doubtful accounts of \$3,521 in 2014 and \$3,346 in 2013	76,910	82,110
Inventories	35,503	37,685
Prepaid expenses and other current assets	12,369	11,904
Deferred income tax	9,060	8,956
Total current assets	189,860	196,761
Property and equipment, net	21,108	23,295
Intangible assets	98,529	98,820
Goodwill	100,931	97,238
Other assets	9,285	10,324
Total assets	\$ 419,713	\$ 426,438
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 24,979	\$ 29,777
Current portion of long-term debt	10,409	10,517
Accrued liabilities	23,429	26,831
Deferred revenue	11,409	12,946
Total current liabilities	70,226	80,071
Long-term liabilities:		
Long-term debt, net of current portion	6,000	27,500
Other liabilities	2,310	2,845
Deferred income tax	10,765	9,704
Total liabilities	89,301	120,120
Stockholders equity:		
	306,127	292,055

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Common Stock, \$0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 32,265,997 in 2014 and 30,751,056 in 2013		
Retained earnings	48,508	34,516
Accumulated other comprehensive loss	(24,223)	(20,253)
Total stockholders' equity	330,412	306,318
Total liabilities and stockholders' equity	\$ 419,713	\$ 426,438

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

Table of Contents**NATUS MEDICAL INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME****(unaudited)****(in thousands, except per share amounts)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Revenue	\$ 86,325	\$ 82,250	\$ 171,948	\$ 168,084
Cost of revenue	35,295	33,859	71,028	70,460
Gross profit	51,029	48,391	100,920	97,624
Operating expenses:				
Marketing and selling	22,028	21,848	43,451	43,969
Research and development	7,873	8,626	15,381	16,801
General and administrative	10,823	11,759	23,103	25,837
Total operating expenses	40,724	42,233	81,934	86,607
Income from operations	10,305	6,158	18,986	11,017
Other income (expense), net	795	(523)	1,107	(856)
Income before provision for income tax	11,100	5,635	20,093	10,161
Provision for income tax expense	3,359	1,615	6,101	2,699
Net income	\$ 7,741	\$ 4,020	\$ 13,991	\$ 7,462
Foreign currency translation adjustment	(1,078)	(998)	(3,969)	(3,329)
Comprehensive income	\$ 6,662	\$ 3,022	\$ 10,022	\$ 4,133
Earnings per share:				
Basic	\$ 0.25	\$ 0.14	\$ 0.45	\$ 0.25
Diluted	\$ 0.24	\$ 0.13	\$ 0.43	\$ 0.24
Weighted average shares used in the calculation of earnings per share:				
Basic	31,424	29,666	31,244	29,685
Diluted	32,444	30,468	32,315	30,470

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

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**NATUS MEDICAL INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

(in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating activities:</b>		
Net income	\$ 13,991	\$ 7,462
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	5,626	6,313
Provision for losses on accounts receivable	98	232
Warranty reserve	595	771
Loss on disposal of property and equipment		26
Share-based compensation	3,177	3,179
Excess tax benefit on the exercise of stock options	(2,746)	(403)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	3,880	4,574
Inventories	2,699	(448)
Prepaid expenses and other assets	(144)	(112)
Accounts payable	(4,010)	(6,473)
Deferred income tax	2,323	(984)
Accrued liabilities and deferred revenue	(6,346)	(9,463)
<b>Net cash provided by operating activities</b>	<b>19,142</b>	<b>4,674</b>
<b>Investing activities:</b>		
Acquisition of businesses, net of cash acquired	(4,925)	(18,600)
Purchases of property and equipment	(2,199)	(1,514)
Purchase of intangible assets	(576)	(768)
<b>Net cash used in investing activities</b>	<b>(7,700)</b>	<b>(20,882)</b>
<b>Financing activities:</b>		
Proceeds from stock option exercises and ESPP purchases	9,454	3,847
Excess tax benefit on the exercise of stock options	2,746	403
Repurchase of common stock	(1,208)	
Proceeds from long-term borrowings		55,300
Payments on borrowings	(21,608)	(37,586)
<b>Net cash provided by (used in) financing activities</b>	<b>(10,616)</b>	<b>21,964</b>
Exchange rate changes effect on cash and cash equivalents	(915)	97



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Net increase (decrease) in cash and cash equivalents	(88)	5,853
Cash and cash equivalents, beginning of period	56,106	23,057
Cash and cash equivalents, end of period	\$ 56,018	\$ 28,910
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 309	\$ 946
Cash paid for income taxes	\$ 3,955	\$ 7,527
Non-cash investing activities:		
Property and equipment included in accounts payable	\$ 187	\$ 268
Inventory transferred to property and equipment	\$ 510	\$ 719

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

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**NATUS MEDICAL INCORPORATED AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)**

**1 - Basis of Presentation**

The accompanying interim condensed consolidated financial statements of Natus Medical Incorporated ( Natus, we, us, our, or the Company ) have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). The accounting policies followed in the preparation of the interim condensed consolidated financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Interim financial reports are prepared in accordance with the rules and regulations of the Securities and Exchange Commission; accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. The interim financial information is unaudited, and except for the prior period correction of errors disclosed below, reflects all normal adjustments that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The condensed consolidated balance sheet as of December 31, 2013 was derived from audited financial statements, but does not include all disclosures required by GAAP. The accompanying financial statements should be read in conjunction with the financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Operating results for the six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

During the second quarter 2014 we identified two prior period misstatements which we consider to be immaterial to the overall financial statements. The first related to the amortization of intangible assets. Amortization expense was recorded on a straight line basis in United States Dollars ( USD ) for foreign entities when the expense should have been recorded on a straight line basis in the entities functional currencies. As a result there was a \$1.1 million adjustment to reduce amortization expense in the second quarter 2014 related to prior periods. See Note 5 Intangible Assets. The second related to the revaluation of two intercompany loans acquired in the acquisition of the Nicolet neurodiagnostic business from CareFusion on July 2, 2012. The revaluation of these loans was recorded to Other Comprehensive Income rather than Foreign Exchange Gain or Loss. This resulted in a \$1.2 million reclassification from Other Comprehensive Income to Foreign Exchange Gains in the second quarter of 2014. See Note 11 Other Income (Expense), net.

**Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 sets forth a new revenue recognition model that requires identifying the contract, identifying the performance obligations, determining the transaction price, allocating the transaction price to performance obligations and recognizing the revenue upon satisfaction of performance obligations. The Company is currently evaluating the impact of ASU 2014-09, which is effective for the Company in our fiscal year ending December 31, 2016.

## 2 - Business Combinations

### Grass Technologies

On February 2, 2013, we completed an asset purchase of the Grass Technologies Product Group ( Grass ) from Astro-Med Inc. for a total cash consideration of \$21.0 million. Included in the total cash consideration is an adjustment of \$2.4 million made in the first quarter of 2014 for inventory purchase commitments. Grass manufactures and sells clinically differentiated neurodiagnostic and monitoring products, including a portfolio of electroencephalography (EEG) and polysomnography (PSG) systems for both clinical and research use and related accessories and proprietary electrodes. The acquisition strengthened the Company s existing neurology portfolio and provided new product categories. A total of \$0.6 million of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

Approximately \$7.0 million has been allocated to goodwill. Goodwill is calculated as the difference between the acquisition date fair value of the consideration transferred and the values assigned to the assets acquired and liabilities assumed and represent primarily the expected synergies of combining the operations of the Company and the Grass

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business. The goodwill is amortizable over 15 years for tax purposes. In accordance with ASC 350-20, goodwill will not be amortized but instead will be tested for impairment at least annually (more frequently if certain indicators are present).

**Pro forma financial information**

The following unaudited pro forma information combining results of operations of the Company for the six months ended June 30, 2013 are presented as if the acquisition of Grass had occurred on January 1, 2013:

**Unaudited Pro forma Financial Information**

(in thousands)

	<b>Six Months Ended June 30, 2013</b>
Revenue	\$ 169,089
Income from operations	\$ 11,725

The unaudited pro forma financial information is provided for comparative purposes only and is not necessarily indicative of what actual results would have been had the acquisitions occurred on the dates indicated, nor does it give effect to synergies, cost savings, and other changes expected to result from the acquisitions. Accordingly, the pro forma financial results do not purport to be indicative of results of operations as of the date hereof, for any period ended on the date hereof, or for any other future date or period.

For purposes of preparing the unaudited pro forma financial information for the period January 1, 2013 through June 30, 2013, Grass' statement of operations for the period from January 1, 2013 to February 1, 2013 was combined with our consolidated statement of operations and comprehensive income for the six months ended June 30, 2013.

The unaudited pro forma consolidated results for the six month period ended June 30, 2013 reflect the historical information of Natus and Grass, adjusted for the following pre-tax amounts:

Additional amortization expense of \$59,300 related to the fair value of identifiable intangible assets acquired;

Decrease of depreciation expense of \$14,800 related to the fair value adjustment to property and equipment acquired;

Decrease in general and administrative expense of \$624,000 related to the direct acquisition costs

**Hearing Screening as a Service**

In the first quarter of 2014, the company entered into two asset purchase agreements for companies in the newborn hearing screening services market for a total consideration of \$2.6 million. Both acquisitions support the Company's

objective to enter this market that complements our newborn hearing screening device business.

### **3 - Basic and Diluted Earnings Per Common Share**

Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share is based upon the weighted average number of common shares outstanding and dilutive common stock equivalents outstanding during the period. Common stock equivalents are options granted and shares of restricted stock issued under our stock awards plans and are calculated under the treasury stock method. Common equivalent shares from unexercised stock options and unvested restricted stock are excluded from the computation when there is a loss as their effect is anti-dilutive or if the exercise price of such unexercised options is greater than the average market price of the stock for the period.

For the three and six months ended June 30, 2014, common stock equivalents of 1,019,887 and 1,071,503 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 232,929 and 231,224 shares, respectively, were excluded from the calculation of diluted earnings per share because the exercise price of the underlying options was greater than the average market price of the stock for the period.

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Inventories consist of the following (in thousands):

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Raw materials and subassemblies	\$ 19,477	\$ 24,312
Work in process	2,067	2,584
Finished goods	20,509	17,861
Total inventories	42,053	44,757
Less: Non-current inventories	(6,550)	(7,072)
Inventories, current		