NATUS MEDICAL INC
Form 10-Q
August 08, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

¨ **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	**77-0154833**
(State or other jurisdiction of incorporation or organization)	**(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 x No ¨

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

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

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

The number of issued and outstanding shares of the registrant s Common Stock, $0.001 par value, as of August 2, 2013 was 30,745,831.

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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)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,910	$ 23,057
Accounts receivable, net of allowance for doubtful accounts of $3,346 in 2013 and $2,617 in 2012	87,557	89,960
Inventories	38,906	40,756
Prepaid expenses and other current assets	5,975	6,379
Deferred income tax	8,631	8,719
Total current assets	169,979	168,871
Property and equipment, net	25,842	26,512
Intangible assets	103,180	96,594
Goodwill	97,364	92,048
Other assets	8,445	7,828
Total assets	$ 404,810	$ 391,853
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 25,811	$ 32,537
Short-term borrowings		11,300
Current portion of long-term debt	10,182	8,526
Accrued liabilities	24,007	32,938
Deferred revenue	11,951	13,305
Total current liabilities	71,951	98,606
Long-term liabilities:		
Long-term debt, net of current portion	40,381	13,034
Other liabilities	3,779	3,038
Deferred income tax	9,341	8,423
Total liabilities	125,452	123,101
Stockholders equity:		
Common Stock, $0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 30,751,056 in 2013 and 30,106,933 in 2012	281,867	275,395
Retained earnings	19,101	11,638
Accumulated other comprehensive loss	(21,610)	(18,281)
Total stockholders equity	279,358	268,752

Total liabilities and stockholders equity	$ 404,810	$ 391,853

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 OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(unaudited)

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Revenue	$ 82,250	$ 61,032	$ 168,084	$ 120,440
Cost of revenue	33,859	26,695	70,460	52,781
Gross profit	48,391	34,337	97,624	67,659
Operating expenses:				
Marketing and selling	21,848	16,245	43,969	32,888
Research and development	8,626	6,585	16,801	13,331
General and administrative	11,759	10,890	25,837	20,395
Total operating expenses	42,233	33,720	86,607	66,614
Income from operations	6,158	617	11,017	1,045
Other income (expense), net	(523)	297	(856)	477
Income before provision for income tax	5,635	914	10,161	1,522
Provision for income tax expense	1,615	590	2,699	909
Net income	$ 4,020	$ 324	$ 7,462	$ 613
Foreign currency translation adjustment	(998)	(2,371)	(3,329)	(1,960)
Comprehensive income (loss)	$ 3,022	$ (2,047)	$ 4,133	$ (1,347)
Earnings per share:				
Basic	$ 0.14	$ 0.01	$ 0.25	$ 0.02
Diluted	$ 0.13	$ 0.01	$ 0.24	$ 0.02
Weighted average shares used in the calculation of earnings per share:				
Basic	29,666	28,921	29,685	28,888
Diluted	30,468	29,697	30,470	29,610

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)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Operating activities:		
Net income	$ 7,462	$ 613
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,313	5,864
Provision for losses on accounts receivable	232	346
Warranty reserve	771	411
Loss on disposal of property and equipment	26	11
Share-based compensation	3,179	2,536
Excess tax (benefit) expense on the exercise of stock options	(403)	612
Changes in operating assets and liabilities:		
Accounts receivable	4,574	(3,891)
Inventories	(448)	6,638
Prepaid expenses and other assets	(112)	96
Accounts payable	(6,473)	(484)
Deferred income tax	(984)	(443)
Accrued liabilities and deferred revenue	(9,463)	1,773
Net cash provided by operating activities	4,674	14,082
Investing activities:		
Acquisition of businesses, net of cash acquired	(18,600)	(57,931)
Purchases of property and equipment	(1,514)	(2,297)
Purchase of intangible assets	(768)	
Net cash used in investing activities	(20,882)	(60,228)
Financing activities:		
Proceeds from stock option exercises and ESPP purchases	3,847	770
Excess tax benefit (expense) on the exercise of stock options	403	(612)
Proceeds from short-term borrowings		6,000
Proceeds from long-term borrowings	55,300	25,000
Payments on borrowings	(37,586)	(93)
Net cash provided by financing activities	21,964	31,065
Exchange rate changes effect on cash and cash equivalents	97	(778)
Net increase (decrease) in cash and cash equivalents	5,853	(15,859)
Cash and cash equivalents, beginning of period	23,057	32,816
Cash and cash equivalents, end of period	$ 28,910	$ 16,957
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 946	$ 21

Cash paid for income taxes	$ 7,527	$ 2,865
Non-cash investing activities:		
Property and equipment included in accounts payable	$ 268	$ 415
Inventory transferred to property and equipment	$ 719	$ 1,001

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). Except as noted below, 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, 2012.

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, but 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, 2012 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, 2012.

Operating results for the six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. 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.

Recent Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. (ASU) 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This topic requires us to provide information about the amounts reclassified out of accumulated other comprehensive income by component and the line items of net income to which significant amounts are reclassified. This topic is for annual and interim periods beginning after December 15, 2012. The update did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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 cash consideration of $18.6 million. 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 $624,000 of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

The Company has accounted for the acquisition as a business combination. Under the acquisition method of accounting, the assets acquired and liabilities assumed from Grass are recorded in the consolidated financial statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill. Grass s results of operations are included in the consolidated financial statements since February 2, 2013, the date of the acquisition.

Valuing certain components of the acquisition, primarily accounts receivable required us to make significant estimates that may be adjusted in the future; consequently, the purchase price allocation is considered preliminary. Final determination of these estimates could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to goodwill. As of June 30, 3013, there have been no adjustments to the preliminary purchase price.

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Approximately $5.2 million has been allocated to goodwill. Goodwill is calculated as the difference between the acquisition date fair value of the consideration transferred and the provisional 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 business. None of the goodwill is expected to be deductible 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). In the event that management determines that the value of goodwill has become impaired, we will incur an accounting charge for the amount of impairment during the fiscal quarter in which the determination is made.

Grass s revenue of $3.7 million and $5.9 million and income from operations of $687,000 and $1.0 million are included in our condensed consolidated statements of income and comprehensive income for the period from April 1, 2013 to June 30, 2013 and February 2, 2013 (acquisition date) to June 30, 2013, respectively.

Nicolet

We acquired the Nicolet neurodiagnostic business (Nicolet) from CareFusion on July 2, 2012 pursuant to a Share and Acquisition Purchase Agreement. The Nicolet business develops clinically differentiated neurodiagnostic and monitoring products, including a portfolio of electroencephalography (EEG) and electromyography (EMG) systems and related accessories, as well as vascular and obstetric Doppler sensors and connectivity products. The acquisition strengthened the Company s existing neurology portfolio and provided new product categories. The acquisition also better positions the Company in international markets, as over 50 percent of the Nicolet business is in markets outside of the United States.

We acquired all of the outstanding common shares of CareFusion subsidiaries comprising the Nicolet business in the United States, Ireland, and the United Kingdom, and certain assets and liabilities of Nicolet sales divisions principally in China, Brazil, Germany, Italy, the Netherlands, and Spain for $55.5 million. A total of $3.3 million of direct costs associated with the acquisition were expensed as incurred and reported as a component of general and administrative expenses.

The acquisition has been accounted for as a business combination. Under the acquisition method of accounting, the assets acquired and liabilities assumed from Nicolet are recorded in the consolidated financial statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill. Nicolet s results of operations are included in the consolidated financial statements since July 2, 2012, the date of the acquisition.

During the six months ending June 30, 2013, we recorded adjustments to the preliminary purchase price allocation for deferred taxes that resulted in a net increase to goodwill of $256,000.

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 and 2012 are presented as if the acquisitions of Grass and Nicolet had occurred on January 1, 2012:

Unaudited Pro forma Financial Information

(in thousands)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenue	$ 169,089	$ 179,238
Income from operations	$ 12,464	$ 2,484

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.

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For purposes of preparing the unaudited pro forma financial information for the period January 1, 2013 through June 30, 2013, Grass s 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 (loss) for the six months ended June 30, 2013.

For purposes of preparing the unaudited pro forma financial information for the period January 1, 2012 through June 30, 2012, Grass s statement of operations and Nicolet s consolidated statement of revenue and direct expenses for the six months ended June 30, 2012 were combined with our consolidated statement of operations and comprehensive income (loss) for the six months ended June 30, 2012.

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 that were recorded in the unaudited pro forma financial information in the six months ended June 30, 2012.

The unaudited pro forma consolidated results for the six month period ended June 30, 2012 reflect the historical information of Natus, Grass and Nicolet, adjusted for the following pre-tax amounts:

Elimination of Nicolet s historical intangible asset amortization expense of approximately $423,000;

Additional amortization expense related to Grass of $356,000 and Nicolet of $565,000 related to the fair value of identifiable intangible assets acquired;

Decrease of Grass s depreciation expense of approximately $89,000 and Nicolet s depreciation expense of approximately $782,000 related to the fair value adjustment to property and equipment acquired;

Increase in general and administrative expense relating to Grass s direct acquisition costs of approximately $533,000 and Nicolet s direct acquisition costs of $3.3 million;

Increase in cost of goods sold relating to Nicolet s fair value inventory adjustments of $571,000.

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, 2013, common stock equivalents of 801,327 and 785,431 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 1,583,695 and 1,552,230 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.

For the three and six months ended June 30, 2012, common stock equivalents of 776,433 and 721,978 shares, respectively were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 1,797,145 and 2,047,286 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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4 Inventories

Inventories consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Raw materials and subassemblies	$ 19,206	$ 21,373
Work in process	3,214	3,085
Finished goods	20,907	19,795
Total inventories	43,327	44,253
Less: Non-current inventories	(4,421)	(3,497)
Inventories, current	$ 38,906	$ 40,756

At June 30, 2013 and December 31, 2012, the Company has classified $4.4 million and $3.5 million of inventories, respectively, as non-current. This inventory consists primarily of service components used to repair products pursuant to warranty obligations and extended service contracts, including service components for products we are not currently selling. Management believes that these inventories will be utilized for their intended purpose.

5 Intangible Assets

The following table summarizes the components of gross and net intangible asset balances (in thousands):

	June 30, 2013				December 31, 2012			
	Gross Carrying Amount	Accumulated Impairment	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Impairment	Accumulated Amortization	Net Book Value
Intangible assets with definite lives:								
Technology	$ 66,380		$ (23,066)	$ 43,314	$ 63,880		$ (20,901)	$ 42,979
Customer related	32,148		(8,885)	23,263	26,948		(7,563)	19,385
Internally developed software	10,558		(4,554)	6,004	9,790		(4,045)	5,745
Patents	2,812		(1,986)	826	2,812		(1,925)	887
Backlog	724		(724)		724		(724)	
Definite-lived intangible assets	112,622		(39,215)	73,407	104,154		(35,158)	68,996
Intangible assets with indefinite lives:								
Tradenames	33,770	(1,560)		32,210	30,778	(1,560)		29,218
Total Intangibles before translation	146,392	(1,560)	(39,215)	105,617	134,932	(1,560)	(35,158)	98,214
Translation	(2,854)		417	(2,437)	(1,864)		244	(1,620)
Total intangibles assets	$ 143,538	$ (1,560)	$ (38,798)	$ 103,180	$ 133,068	$ (1,560)	$ (34,914)	$ 96,594

Definite-lived intangible assets are amortized over their weighted average lives of 15 years for technology, 12 years for customer related intangibles, 7 years for internally developed software, and 14 years for patents. Intangible assets with indefinite lives are not subject to amortization.

Internally developed software consists of $9.6 million relating to costs incurred for development of internal use computer software and $943,000 for development of software to be sold.

Amortization expense related to intangible assets with definite lives was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Technology	$ 1,096	$ 670	$ 2,165	$ 1,541
Customer Related	678	393	1,322	896
Internally developed software	244	580	509	1,201
Patents	30	40	61	101
Total amortization	$ 2,048	$ 1,683	$ 4,057	$ 3,739

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Expected amortization expense related to amortizable intangible assets is as follows (in thousands):

Six months ending December 31, 2013	$ 4,061
2014	7,849
2015	7,508
2016	6,674
2017	6,291
2018	6,120
Thereafter	34,904
Total expected amortization expense	$ 73,407

6 Goodwill

The carrying amount of goodwill and the changes in those balances are as follows (in thousands):

Gross Balance, December 31, 2012	$ 112,048
Accumulated impairment losses	(20,000)
Balance net of impairment losses, December 31, 2012	92,048
Goodwill as a result of acquisitions	5,668
Foreign currency translation	(352)
Balance, June 30, 2013	$ 97,364

7 Property and Equipment, net

Property and equipment, net consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Land	$ 4,286	$ 4,371
Buildings	11,009	11,422
Leasehold improvements	3,661	3,450
Office furniture and equipment	12,053	11,601
Computer software and hardware	11,106	10,114
Demonstration and loaned equipment	11,203	11,505
	53,318	52,463
Accumulated depreciation and amortization	(27,476)	(25,951)
Total	$ 25,842	$ 26,512

Depreciation and amortization expense of property and equipment was approximately $1.2 and $2.3 million for the three and six months ended June 30, 2013, respectively, and was approximately $1.3 and $2.2 million for the three and six months ended June 30, 2012, respectively.

8 Reserve for Product Warranties

We provide a warranty on all medical device products that is generally one year in length. We also sell extended service agreements on our medical device products. Service for domestic customers is provided by Company-owned service centers that perform all service, repair, and calibration services. Service for international customers is provided by a combination of Company-owned facilities and third-party vendors on a contract basis.

We have accrued a warranty reserve, included in accrued liabilities on the accompanying balance sheets, for the expected future costs of servicing products during the initial warranty period. We base the liability on actual warranty costs incurred to service those products. On new products, additions to the reserve are based on a combination of factors including the percentage of service department labor applied to warranty repairs, as well as actual service department costs, and other judgments, such as the degree to which the product incorporates new technology. The reserve is reduced as costs are incurred to honor existing warranty obligations.

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The details of activity in the warranty reserve are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Balance, beginning of period	$ 2,643	$ 2,275	$ 2,260	$ 2,157
Acquisition warranty assumed				