

NATUS MEDICAL INC
Form 10-Q
November 07, 2011
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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 September 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: 000-33001

NATUS MEDICAL INCORPORATED

(Exact name of registrant as specified in its charter)

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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 October 31, 2011 was 29,390,511.

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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 amounts)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 30,776	\$ 28,383
Short-term investments		1,005
Accounts receivable, net of allowance for doubtful accounts of \$956 in 2011 and \$1,643 in 2010	48,693	54,782
Inventories	40,269	37,627
Prepaid expenses and other current assets	4,441	4,954
Deferred income tax	4,047	2,192
Total current assets	128,226	128,943
Property and equipment, net	24,949	23,408
Intangible assets	73,202	69,428
Goodwill	99,683	96,819
Other assets	5,248	12,449
Total assets	\$ 331,308	\$ 331,047
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 15,778	\$ 21,684
Short-term loans and current portion of long-term debt	726	705
Accrued liabilities	17,456	17,888
Deferred revenue	7,066	4,744
Total current liabilities	41,026	45,021
Long-term liabilities:		
Long-term debt	619	737
Other liabilities	7,482	8,076
Deferred income tax	7,187	13,958
Total liabilities	56,314	67,792
Stockholders' equity:		
Common Stock, \$0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 29,389,011 in 2011 and 28,922,667 in 2010	266,066	258,872
Retained earnings	23,676	18,057

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Accumulated other comprehensive loss	(14,748)	(13,674)
Total stockholders' equity	274,994	263,255
Total liabilities and stockholders' equity	\$ 331,308	\$ 331,047

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 (unaudited)

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue	\$ 51,338	\$ 53,179	\$ 168,541	\$ 155,485
Cost of revenue	23,765	21,757	73,165	62,700
Gross profit	27,573	31,422	95,376	92,785
Operating expenses:				
Marketing and selling	14,688	12,817	44,818	40,334
Research and development	6,119	4,820	18,577	15,188
General and administrative	7,809	8,074	24,828	26,875
Total operating expenses	28,616	25,711	88,223	82,397
Income (loss) from operations	(1,043)	5,711	7,153	10,388
Other income (expense), net	186	(176)	(28)	9
Income (loss) before provision for income tax	(857)	5,535	7,125	10,397
Provision for income tax (benefit) expense	(1,011)	1,898	1,507	3,727
Net income	\$ 154	\$ 3,637	\$ 5,618	\$ 6,670
Earnings per share:				
Basic	\$ 0.01	\$ 0.12	\$ 0.20	\$ 0.24
Diluted	\$ 0.01	\$ 0.12	\$ 0.19	\$ 0.23
Weighted average shares used in the calculation of earnings per share:				
Basic	28,643	28,212	28,477	28,021
Diluted	29,387	29,261	29,566	29,170

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 CASH FLOWS (unaudited)**

(in thousands)

	Nine Months Ended September 30,	
	2011	2010
Operating activities:		
Net income	\$ 5,618	\$ 6,670
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,771	6,467
Accounts receivable reserves	1,065	112
Warranty reserves	1,225	180
Loss on disposal of property and equipment	187	72
Share-based compensation	5,028	4,013
Change in fair value of contingent obligation	(1,200)	
Excess tax benefits on the exercise of options	(299)	(574)
Impairment of intangible assets		300
Changes in operating assets and liabilities:		
Accounts receivable	8,433	2,085
Inventories	(872)	(6,068)
Prepaid expenses and other assets	1,032	(891)
Accounts payable	(8,062)	(859)
Deferred income tax	(350)	475
Accrued liabilities and deferred revenue	(1,927)	(2,388)
Net cash provided by operating activities	16,649	9,594
Investing activities:		
Cash paid for business acquisitions, net of cash acquired	(14,935)	(19)
Purchases of property and equipment	(2,193)	(2,553)
Purchase of intangible assets	(160)	
Capitalized software development costs		(215)
Purchases of marketable securities		(975)
Sales of marketable securities	1,005	975
Net cash used in investing activities	(16,283)	(2,787)
Financing activities:		
Proceeds from stock option exercises and ESPP purchases	1,868	2,033
Excess tax benefits on the exercise of options	299	574
Proceeds from short-term borrowings	2,553	
Payments on borrowings	(2,119)	(134)
Net cash provided by financing activities	2,601	2,473
Exchange rate effect on cash and cash equivalents	(574)	701
Net increase in cash and cash equivalents	2,393	9,981
Cash and cash equivalents, beginning of period	28,383	32,586

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Cash and cash equivalents, end of period	\$ 30,776	\$ 42,567
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 94	\$ 44
Cash paid for income taxes	\$ 1,912	\$ 4,111
Non-cash investing activities:		
Contingent earnout obligations included in accrued liabilities	\$ 800	\$

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

Table of Contents**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, 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, 2010.

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. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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.

Comprehensive Income

Comprehensive income is comprised of net income and gains or losses resulting from currency translations of foreign investments. The details of comprehensive income are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	\$ 154	\$ 3,637	\$ 5,618	\$ 6,670
Foreign currency translation adjustment	(2,672)	1,990	(1,074)	(178)
Comprehensive income (loss)	\$ (2,518)	\$ 5,627	\$ 4,544	\$ 6,492

Stockholders Equity

The details of changes in stockholders equity are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 275,128	\$ 249,538	\$ 263,255	\$ 243,557
Net income	154	3,637	5,618	6,670
Proceeds from stock option exercises and ESPP	470	26	1,868	2,033
Share-based compensation expense	1,911	1,683	5,028	4,013
Tax effect of option exercises	3	(205)	299	574
Foreign currency translation adjustment	(2,672)	1,990	(1,074)	(178)
Balance, end of period	\$ 274,994	\$ 256,669	\$ 274,994	\$ 256,669

Recent Accounting Pronouncements

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Intangibles Goodwill and Other: In September 2011, the FASB issued amended guidance related to *Intangibles - Goodwill and Other: Testing Goodwill for Impairment*. The amendment is intended to simplify how entities test goodwill for impairment. The amendment permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. This amendment is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company does not believe that this guidance will have a material impact on its condensed consolidated financial statements.

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In December 2010, the FASB issued amended guidance related to *Intangibles - Goodwill and Other*. The amendments modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements.

Comprehensive Income: In June 2011, the Financial Accounting Standards Board (FASB) issued amended guidance related to Comprehensive Income. This amendment allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendment eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendment should be applied retrospectively. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company does not believe that this guidance will have a material impact on its condensed consolidated financial statements.

Fair Value Measurements: In May 2011, the FASB issued amended guidance related to Fair Value Measurements. This amendment represents the converged guidance of the FASB and the International Accounting Standards Board (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in this amendment, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term fair value. The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The Company does not believe that this guidance will have a material impact on its condensed consolidated financial statements.

Business Combinations: In December 2010, the FASB issued amended guidance related to Business Combinations. The amendments affect any public entity that enters into business combinations that are material on an individual or aggregate basis. The amendments specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company adopted the new disclosure requirements for its annual report for the year ended December 31, 2010 and in subsequent interim reports.

2 - Business Combinations**Embla Systems LLC**

We acquired Embla Systems LLC (Embla) on September 15, 2011 pursuant to an Equity Purchase Agreement. Embla, with corporate headquarters in Denver, Colorado develops, manufactures, and sells devices focused on diagnostic sleep analysis (Polysomnography or PSG), with products sold into the hospital and dedicated sleep lab as well as home sleep testing devices.

The Company acquired all of the capital stock of Embla for \$16.1 million in cash at closing, excluding direct costs of the acquisition, with the potential for additional purchase consideration based on minimum cash and net asset targets as of the purchase date. The Company paid an additional \$472,000 of purchase consideration in October 2011 based on the minimum cash target. A total of \$290,000 of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

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The acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed from Embla 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 in the amount of \$2.9 million. Embla's results of operations are included in the consolidated financial statements from the date of the acquisition.

The determination of estimated fair value of acquired assets and liabilities requires management to make significant estimates and assumptions. We determined the fair value by applying established valuation techniques, based on information that management believed to be relevant to this determination. The Company also hired independent third parties to assist in the valuation of intangible assets and goodwill.

The following table summarizes the purchase price allocation of the fair value of the assets acquired and liabilities assumed at the date of acquisition, (in thousands):

Cash	\$ 1,028
Accounts receivable	3,717
Inventories	5,333
Prepaid and other assets	403
Deferred income tax	382
Identifiable intangible assets:	
Core Technology	900
Developed Technology	2,100
Customer-related	1,300
Tradenames	3,500
In-Process Research and Development	400
Property and equipment	101
Goodwill	2,874
Accounts payable	(2,396)
Accrued expenses	(1,773)
Deferred income tax	(215)
Deferred revenue	(1,082)
Total purchase price	\$ 16,572

Valuing certain components of the acquisition, including primarily accounts receivable, inventory, identifiable intangible assets, deferred taxes, accrued warranty costs, accounts payable, other accrued expenses and deferred revenue required us to make 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.

Identifiable intangible assets. Intangible assets included in the purchase price allocation consist of: (i) technology of \$3.0 million assigned an average economic life of 18 years being amortized on the straight line method, (ii) customer-related intangible assets of \$1.3 million assigned an economic life of 14 years being amortized on the straight line method, and (iii) tradenames of \$3.5 million that have an indefinite life and are not being amortized.

IPR&D. A portion of the purchase price was allocated to in-process research and development (IPR&D) in the amount of \$400,000. The fair value of the IPR&D was determined through estimates and valuation techniques through an analysis of data provided by Embla concerning developmental products, their stage of development, the time and resources needed to complete them, their expected income generating ability and associated risks. IPR&D is accounted for as an indefinite-lived intangible asset until completion or abandonment of the associated research and development efforts. IPR&D will be tested for impairment annually or when impairment indicators are present.

Goodwill. Approximately \$2.9 million has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. This goodwill is expected to be non-deductible for tax purposes. 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 the impairment during the quarter in which the determination is made.

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Deferred income tax. A preliminary estimate of \$382,000 has been allocated to non-current deferred tax assets and \$215,000 has been allocated to non-current deferred tax liabilities, which results primarily from investment tax credits and a portion of customer-related intangible assets.

Medix Industrial y Commercial S.A.

We acquired Medix Industrial y Commercial S.A. (Medix) on October 12, 2010 pursuant to an Agreement and Plan of Merger. Medix develops, manufactures, and sells devices for newborn care, primarily in Latin America. Medix, based in Argentina, manufactures incubators for use in hospital nurseries and NICU s, transport incubators for use in ambulances and other emergency vehicles, infant warmers, and LED based phototherapy devices.

The Company acquired all of the capital stock of Medix for \$14.1 million in cash, excluding direct costs of the acquisition. The Company is obligated to pay additional purchase consideration to the former shareholders of Medix if certain revenue targets are met in 2011 and 2012. At the time of the acquisition the Company recorded an estimate of the fair value of the contingent earnout obligation in the amount of \$2.0 million based on future revenue projections of the Medix business under various potential scenarios applying weighted probability assumptions of their outcomes. As of September 30, 2011, the original estimate has been adjusted downwards to \$800,000 and no payments have been made against the contingent earnout obligation.

During the nine months ended September 30, 2011, the Company recorded adjustments to its original estimate of the purchase-date fair value of deferred taxes in the amount of \$364,000 and recorded a reduction of the purchase consideration based on a minimum working capital provision of the purchase agreement. These actions resulted in a net decrease in the carrying amount of goodwill of approximately \$137,000 in the three months ended September 30, 2011, and an increase of approximately \$227,000 for the nine months ended September 30, 2011.

Proforma financial information

The following unaudited pro forma combined results of operations of the Company for the nine months ended September 30, 2011 are presented as if the acquisition of Embla had occurred on the first day of the period presented and for the nine months ended September 30, 2010 as if the acquisitions of Medix and Embla had occurred on the first day of the period presented:

Unaudited Pro Forma Financial Information

(in thousands)

	Nine Months Ended September 30,	
	2011	2010
Revenue	\$ 188,643	\$ 192,994
Income from operations	\$ 7,705	\$ 12,997

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 do they 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 nine months ended September 30, 2011, Embla s Consolidated Statement of Income for the period January 1, 2011 through September 15, 2011 was combined with the Company s Consolidated Statement of Operations for the period January 1, 2011 through September 30, 2011.

For purposes of preparing the unaudited pro forma financial information for the nine months ended September 30, 2010, Medix s Statement of Income for the period January 1, 2010 through September 30, 2010 and Embla s Consolidated Statement of Income for the period January 1, 2010 through September 30, 2010 were combined with the Company s Consolidated Statement of Operations for the nine months ended September 30, 2010.

The unaudited proforma consolidated results reflect the historical information of Natus and Embla in 2011 and Natus, Medix and Embla in 2010, adjusted for the following pre-tax amounts:

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Elimination of Embla's historical intangible asset amortization expense (approximately \$157,000 through September 14, 2011 and \$157,000 in 2010).

Additional amortization expense related to Embla (approximately \$208,000 through September 14, 2011 and \$208,000 in 2010) related to the fair value of identifiable intangible assets acquired.

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Decrease of Embla's depreciation expense (approximately \$295,000 through September 14, 2011 and \$295,000 in 2010) related to the fair value adjustment to property and equipment acquired.

Additional amortization expense related to Medix (approximately \$251,000 through October 12, 2010) related to the fair value of identifiable intangible assets acquired.

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 nine months ended September 30, 2011, common stock equivalents of 744,067 and 1,088,511 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 2,326,775 and 1,500,284 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 periods. For the three and nine months ended September 30, 2010, common stock equivalents of 1,049,368 and 1,148,698 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 1,387,463 and 999,899 shares, respectively, were excluded from the calculation of diluted earnings per share because of their anti-dilutive effect.

4 - Inventories

Inventories consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Raw materials and subassemblies	\$ 13,663	\$ 14,924
Finished goods	31,106	26,375
Total inventories	44,769	41,299
Less: Non-current inventories	(4,500)	(3,672)
Inventories, current	\$ 40,269	\$ 37,627

The balances above include approximately \$5.6 million of Embla inventory as of September 30, 2011. Non-current inventories consist primarily of service components used to repair products held by our customers including some products we are not currently selling and are reported as a component of other assets. Management believes that these inventories will be utilized for their intended purpose.

Work in process represents an immaterial amount in all periods presented.

5 - Goodwill and Intangible Assets**Goodwill**

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

Balance, January 1, 2010	\$ 92,258
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Goodwill as a result of acquisitions	4,834
Purchase accounting adjustments	(14)
Foreign currency translation	(259)
Balance, December 31, 2010	96,819
Goodwill as a result of acquisitions	2,874
Purchase accounting adjustments	227
Foreign currency translation	(237)
Balance, September 30, 2011	\$ 99,683

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

	September 30, 2011			December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Intangible assets with definite lives:						
Technology	\$ 53,024	\$ (16,873)	\$ 36,151	\$ 50,301	\$ (14,520)	\$ 35,781
Customer related	16,902	(4,214)	12,688	15,299	(3,016)	12,283
Internally developed software	3,798	(1,903)	1,895	3,831	(1,392)	2,439
Patents	2,788	(1,905)	883	2,571	(1,746)	825
Definite lived intangible assets	76,512	(24,895)	51,617	72,002	(20,674)	51,328
Intangible assets with indefinite lives:						
Tradenames	21,585		21,585	18,100		18,100
Total intangibles assets	\$ 98,097	\$ (24,895)	\$ 73,202	\$ 90,102	\$ (20,674)	\$ 69,428

Definite lived intangible assets are amortized over their weighted average lives of 15 years for technology, 12 years for customer-related intangibles, 2 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 \$2.9 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 September 30, 2011	Nine Months Ended September 30, 2011
Technology	\$ 612	\$ 2,353
Customer Related	331	1,198
Internally developed software	189	511
Patents	46	159
Total amortization	\$ 1,178	\$ 4,221

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

2011	\$ 1,453
2012	6,157
2013	5,195
2014	4,892
2015	4,516
2016	3,726
Thereafter	25,678

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Total expected amortization expense

\$ 51,617

6 - Property and Equipment, net

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

	September 30, 2011	December 31, 2010
Land	\$ 4,442	\$ 4,903
Buildings	10,997	10,904
Leasehold improvements	2,715	2,523
Office furniture and equipment	10,295	9,067
Computer software and hardware	6,405	6,084
Demonstration and loaned equipment	10,756	7,571
	45,610	41,052
Accumulated depreciation	(20,661)	(17,644)
Total	\$ 24,949	\$ 23,408

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Depreciation and amortization expense of property and equipment was \$868,000 and \$2.4 million for the three and nine months ended September 30, 2011, respectively, and was \$850,000 and \$2.4 million for the three and nine months ended September 30, 2010, respectively.

7 - 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 or when current facts indicate that the original estimates of expected future costs of servicing products were overstated.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 1,394	\$ 563	\$ 696	\$ 694
Warranty accrued for the period	92	94	1,224	180
Repairs for the period	(266)	(86)	(700)	(303)
Balance, end of period	\$ 1,220	\$ 571	\$ 1,220	\$ 571

The estimates we use in projecting future product warranty costs may prove to be incorrect. Any future determination that our product warranty reserves are understated could result in increases to our cost of sales and reductions in our operating profits and results of operations.

8 - Share-Based Compensation

At September 30, 2011, we have two plans that give rise to share-based compensation, the 2011 Stock Awards Plan and the 2011 Employee Stock Purchase Plan. The terms of awards granted during the nine months ended September 30, 2011 and our methods for determining grant-date fair value of the awards were consistent with those described in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

Detail of share-based compensation expense is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Cost of revenue	\$ 87	\$ 41	\$ 224	\$ 111
Marketing and sales	486	493	1,196	1,096
Research and development	131	90	400	296
General and administrative	1,207	1,059	3,208	2,510
Total	\$ 1,911	\$ 1,683	\$ 5,028	\$ 4,013

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As of September 30, 2011, unrecognized compensation expense related to the unvested portion of our stock options and other stock awards was approximately \$14.7 million, which is expected to be recognized over a weighted average period of 2.6 years.

Stock Options

Activity in our stock options during the nine months ended September 30, 2011 is as follows:

	Shares	Weighted Average Exercise Price	Weighted- average remaining contractual life (years)	Aggregate intrinsic value (\$ 000 s)
Outstanding, beginning of period	3,638,957	\$ 10.94		
Granted	541,350	\$ 16.09		
Exercised	(185,404)	\$ 7.57		
Cancelled	(133,610)	\$ 15.25		
Outstanding, end of period	3,861,293	\$ 11.67	3.27	\$ 5,305
Exercisable, end of period	2,777,482	\$ 10.32	2.68	\$ 5,296
Vested and expected to vest, end of period	3,739,606	\$ 11.55	3.21	\$ 5,304

The intrinsic value of options exercised during the nine months ended September 30, 2011 was \$410,000.

Restricted Stock Awards

Activity in our restricted stock awards during the nine months ended September 30, 2011 is as follows:

	Shares	Weighted- average grant date fair value	Remaining cost expected to be recognized (\$ 000 s)
Unvested, beginning of period	590,050	\$ 14.30	
Granted	260,375	\$ 16.22	
Vested	(218,405)	\$ 13.59	
Forfeited	(27,800)	\$ 14.63	
Unvested, end of period	604,220	\$ 15.37	\$ 8,900

We award restricted stock awards (RSA s) to U.S. employees of the Company that vest 50% upon the second anniversary of the vesting start date and 25% upon each of the third and fourth anniversaries of the vesting start date. We also award RSA s to non-employee directors of the Company that vest on the first anniversary of the grant date.

At September 30, 2011 the fair market value of outstanding RSA s was \$5.9 million and the weighted average remaining recognition period was 2.7 years. At December 31, 2010 the fair market value of outstanding RSA s was \$8.5 million and the weighted average remaining recognition period for unvested RSA s was 2.6 years. The intrinsic value of RSA s equals their fair market value.

Restricted Stock Units

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Activity in our restricted stock units during the nine months ended September 30, 2011 is as follows:

	Shares	Weighted- average remaining contractual life (years)	Aggregate intrinsic value (\$ 000 s)
Outstanding, beginning of period	71,300		
Awarded	22,800		
Released	(20,375)		
Forfeited	(12,850)		
Outstanding, end of period	60,875	1.77	\$ 595

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We award restricted stock units (RSU s) to non-U.S. employees of the Company that vest 50% upon the second anniversary of the vesting start date and 25% upon each of the third and fourth anniversaries of the vesting start date.

At September 30, 2011 the weighted average remaining recognition period was 2.8 years. At December 31, 2010 the aggregate intrinsic value of outstanding RSU s was \$1.0 million and the weighted average remaining recognition period for unvested RSU s was 2.9 years.

9 - Other income (expense), net

Other income (expense), net consisted of (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Investment income	\$ 6	\$ 34	\$ 23	\$ 30
Interest expense	(47)	(13)	(160)	(49)
Foreign currency exchange gain (loss)	67	(280)	(39)	(647)
Other	160	83	148	675
Total other income (expense), net	\$ 186	\$ (176)	\$ (28)	\$ 9

10 - Income Taxes**Provision for Income Tax**

We recorded a provision for income tax (benefit) expense of \$(1.0) million and \$1.5 million for the three and nine months ended September 30, 2011, respectively. Our effective tax rate was 21.2% for the nine months ended September 30, 2011. The effective rate was lower than the statutory rate primarily because of the expiration of statute of limitation on uncertain tax positions that were recorded as a component of income tax expense in prior years.

We recorded a provision for income tax of \$1.9 million and \$3.7 million for the three and nine months ended September 30, 2010, respectively. Our effective tax rate was 34.3% and 35.8% for the three and nine months ended September 30, 2010, respectively.

Our tax returns remain open to examination as follows: U.S. Federal, 2006 through 2010; U.S. states, generally 2005 through 2010; significant foreign jurisdictions, generally 2007 through 2010.

11 - Restructuring Reserve

In January 2011, we adopted a reorganization plan that was designed to improve efficiencies in the operations of Medix, which we acquired in October 2010. During the three months ended September 30, 2011 we also initiated similar restructuring activities in our North American and European operations. These restructuring activities will be substantially completed in the fourth quarter of 2011.

In January 2010, we adopted a reorganization plan that was designed to eliminate redundant costs resulting from our acquisition of Alpine Biomed (Alpine) and to improve efficiencies in operations. Under the plan, which was substantially completed in the first half of 2010, Alpine operations in Montreal, Canada were transitioned to our existing Xltek facility in Oakville, Ontario, Canada, and Alpine s sales organization was merged into our global sales organization.

The balance of the reserve is included in accrued liabilities on the accompanying balance sheets. Detail of activity in the restructuring reserve is as follows, (in thousands):

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	Nine Months Ended September 30,	
	2011	2010
Balance, beginning of period	\$ 87	\$
Employee termination benefits expensed	2,180	3,030
Lease termination fee		300
Amounts paid	(1,837)	(2,936)
Accrual reversal	(6)	(268)
Balance, end of period	\$ 424	\$ 126

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Long-term borrowings are comprised of the following (2011 and 2010 columns in thousands):

	September 30, 2011	December 31, 2010
Term loan \$2.9 million Canadian (CAD), interest at cost of funds plus 2.5%, due September 15, 2014 with principle repayable in monthly installments of \$16,000 until August 15, 2014 and one final payment of \$404,000 collateralized by a first lien on land and building owned by Xltek	\$ 775	\$ 893
Total long-term debt (including current portion)	775	893
Less: current portion of long-term debt	(156)	(156)
Total long-term debt	\$ 619	\$ 737

At September 30, 2011 the Company had a \$50 million revolving credit facility with Wells Fargo Bank, National Association (Wells Fargo). The revolving credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in substantially all of our assets. We did not draw on the facility during the first nine months of 2011 or during 2010. We have no other significant credit facilities. At September 30, 2011, the Company was not in compliance with a rolling four-quarter EBITDA covenant of the credit facility; the Company received a waiver of such default from Wells Fargo.

13 - Segment, Customer and Geographic Information

We operate in one reportable segment in which we provide healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders.

Our end-user customer base includes hospitals, clinics, laboratories, physicians, nurses, audiologists, and governmental agencies. Most of our international sales are to distributors who resell our products to end-users or sub-distributors.

Revenue and long-lived asset information by geographic region is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue:				
United States	\$ 30,792	\$ 32,090	\$ 95,944	\$ 94,609
Foreign countries	20,546	21,089	72,597	60,876
Totals	\$ 51,338	\$ 53,179	\$ 168,541	\$ 155,485

	September 30, 2011	December 31, 2010
Long-lived assets:		
United States	\$ 8,490	\$ 7,862

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Foreign countries	16,459	15,546
Totals	\$ 24,949	\$ 23,408

Long-lived assets consist principally of net property and equipment. During the three and nine months ended September 30, 2011 and 2010, no single customer or foreign country contributed to more than 10% of revenue, and revenue from services was less than 10% of revenue.

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During the three and nine months ended September 30, 2011, respectively, revenue from devices and systems was \$31.1 and \$107.2 million, while revenue from supplies and services was \$19.2 and \$58.4 million, respectively.

14 - Fair Value of Financial Instruments

The fair value of our assets and liabilities subject to fair value measurements are as follows (in thousands):

	Fair Value as of September 30, 2011	Fair Value Measurements as of September 30, 2011 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 3,148		\$ 3,148	
Fixed rate term deposits				
Total	\$ 3,148		\$ 3,148	

	Fair Value as of December 31, 2010	Fair Value Measurements as of December 31, 2010 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 3,146		\$ 3,146	
Fixed rate term deposits	1,005			