

ORTHOFIX INTERNATIONAL N V

Form 10-Q

May 09, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _____ to _____.

Commission File Number: 0-19961

ORTHOFIX INTERNATIONAL N.V.

(Exact name of registrant as specified in its charter)

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Curaçao
(State or other jurisdiction of
incorporation or organization)

Not applicable
(I.R.S. Employer
Identification No.)

7 Abraham de Veerstraat

Curaçao
(Address of principal executive offices)

Not applicable
(Zip Code)

599-9-4658525

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or smaller reporting company. See definition of "large accelerated filer," "accelerated filer," "non-accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated filer

Accelerated filer

Non-Accelerated filer (Do not check if a smaller reporting company)

Smaller Reporting Company

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

As of May 2, 2013, 19,453,294 shares of common stock were issued and outstanding.

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Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, relating to our business and financial outlook, which are based on our current beliefs, assumptions, expectations, estimates, forecasts and projections. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, projects, intends, predicts, comparable terminology. These forward-looking statements are not guarantees of our future performance and involve risks, uncertainties, estimates and assumptions that are difficult to predict. Therefore, our actual outcomes and results may differ materially from those expressed in these forward-looking statements. You should not place undue reliance on any of these forward-looking statements. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any such statement to reflect new information, the occurrence of future events or circumstances or otherwise.

The forward-looking statements in this filing do not constitute guarantees or promises of future performance. Factors that could cause or contribute to such differences may include, but are not limited to, risks relating to the expected sales of our products, including recently launched products, unanticipated expenditures, changing relationships with customers, suppliers, strategic partners and lenders, changes to and the interpretation of governmental regulations, the resolution of pending litigation matters (including our indemnification obligations with respect to certain product liability claims against, and the government investigation of, our former sports medicine global business unit) (as further described in the *Legal Proceedings* sections of this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Form 10-K)), our ongoing compliance obligations under a corporate integrity agreement with the Office of Inspector General of the Department of Health and Human Services (and related terms of probation) and a deferred prosecution agreement with the U.S. Department of Justice, risks relating to the protection of intellectual property, changes to the reimbursement policies of third parties, the impact of competitive products, changes to the competitive environment, the acceptance of new products in the market, conditions of the orthopedic industry, credit markets and the economy, corporate development and market development activities, including acquisitions or divestitures, unexpected costs or operating unit performance related to recent acquisitions, and other risks described in Item 1A under the heading *Risk Factors* in the 2012 Form 10-K.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****ORTHOFIX INTERNATIONAL N.V.****Condensed Consolidated Balance Sheets**

| (U.S. Dollars, in thousands, except share data) | March 31, 2013 (unaudited) | December 31, 2012 |
|---|----------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 33,675 | \$ 31,055 |
| Restricted cash | 29,446 | 21,314 |
| Trade accounts receivable, less allowances of \$18,032 and \$16,188 at March 31, 2013 and December 31, 2012, respectively | 132,425 | 150,316 |
| Inventories | 92,133 | 88,744 |
| Deferred income taxes | 17,363 | 16,959 |
| Prepaid expenses and other current assets | 32,211 | 32,056 |
| Total current assets | 337,253 | 340,444 |
| Property, plant and equipment, net | 52,402 | 51,362 |
| Patents and other intangible assets, net | 6,765 | 6,880 |
| Goodwill | 72,607 | 74,388 |
| Deferred income taxes | 20,200 | 19,904 |
| Other long-term assets | 14,153 | 11,303 |
| Total assets | \$ 503,380 | \$ 504,281 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Trade accounts payable | \$ 14,230 | \$ 21,812 |
| Other current liabilities | 51,295 | 46,985 |
| Total current liabilities | 65,525 | 68,797 |
| Long-term debt | 20,000 | 20,000 |
| Deferred income taxes | 11,460 | 11,456 |
| Other long-term liabilities | 4,227 | 4,930 |
| Total liabilities | 101,212 | 105,183 |
| Contingencies (Note 16) | | |
| Shareholders' equity: | | |
| Common shares \$0.10 par value; 50,000,000 shares authorized; 19,453,294 and 19,339,329 issued and outstanding as of March 31, 2013 and December 31, 2012, respectively | 1,945 | 1,934 |
| Additional paid-in capital | 250,186 | 246,111 |
| Retained earnings | 150,665 | 148,549 |
| Accumulated other comprehensive income | (628) | 2,504 |
| Total shareholders' equity | 402,168 | 399,098 |
| Total liabilities and shareholders' equity | \$ 503,380 | \$ 504,281 |

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

Table of Contents**ORTHOFIX INTERNATIONAL N.V.****Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)****For the three months ended March 31, 2013 and 2012**

| (Unaudited, U.S. Dollars, in thousands, except share and per share data) | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2013 | 2012 |
| Product sales | \$ 88,358 | \$ 104,820 |
| Marketing service fees | 11,896 | 11,222 |
| Net sales | 100,254 | 116,042 |
| Cost of sales | 22,699 | 21,940 |
| Gross profit | 77,555 | 94,102 |
| Operating expenses | | |
| Sales and marketing | 48,839 | 49,521 |
| General and administrative | 18,788 | 14,570 |
| Research and development | 5,400 | 7,050 |
| Amortization of intangible assets | 504 | 530 |
| | 73,531 | 71,671 |
| Operating income | 4,024 | 22,431 |
| Other income and expense | | |
| Interest expense, net | (560) | (2,221) |
| Other income (expense) | 4,764 | (631) |
| | 4,204 | (2,852) |
| Income before income taxes | 8,228 | 19,579 |
| Income tax expense | (3,320) | (7,363) |
| Net income from continuing operations, net of tax | 4,908 | 12,216 |
| Discontinued operations (Note 15) | | |
| Loss from discontinued operations | (4,432) | (506) |
| Income tax benefit | 1,640 | 306 |
| Net loss from discontinued operations, net of tax | (2,792) | (200) |
| Net income | \$ 2,116 | \$ 12,016 |
| Net income (loss) per common share- basic: | | |
| Net income from continuing operations, net of tax | \$ 0.25 | \$ 0.65 |
| Net loss from discontinued operations, net of tax | (0.14) | (0.01) |
| Net income per common share- basic | \$ 0.11 | \$ 0.64 |
| Net income per common share- diluted: | | |
| Net income from continuing operations, net of tax | \$ 0.25 | \$ 0.64 |
| Net loss from discontinued operations, net of tax | (0.14) | (0.01) |

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| | | |
|--|------------|------------|
| Net income per common share- diluted | \$ 0.11 | \$ 0.63 |
| Weighted average number of common shares: | | |
| Basic | 19,431,093 | 18,675,694 |
| Diluted | 19,691,141 | 19,116,195 |
| Comprehensive (loss) income | \$ (1,016) | \$ 14,726 |

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

Table of Contents**ORTHOFIX INTERNATIONAL N.V.****Condensed Consolidated Statements of Cash Flows****For the three months ended March 31, 2013 and 2012**

| (Unaudited, U.S. Dollars, in thousands) | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net income | \$ 2,116 | \$ 12,016 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,995 | 5,667 |
| Amortization of debt costs | 180 | 296 |
| Provision for doubtful accounts | 3,227 | 3,154 |
| Deferred income taxes | (744) | (828) |
| Share-based compensation | 1,943 | 1,480 |
| Provision for inventory obsolescence | 896 | 649 |
| Excess income tax benefit on employee stock-based awards | (78) | (242) |
| Income tax benefit on employee stock-based awards | 563 | 1,013 |
| Other | (345) | 1,117 |
| Change in operating assets and liabilities: | | |
| Trade accounts receivable | 13,779 | (11,943) |
| Inventories | (5,126) | 732 |
| Escrow receivable | | 41,537 |
| Prepaid expenses and other current assets | (179) | 6,559 |
| Trade accounts payable | (7,242) | (3,103) |
| Other current liabilities | 4,478 | (4,787) |
| Long-term assets | (2,266) | (1,405) |
| Long-term liabilities | (743) | (2,798) |
| Net cash provided by operating activities | 15,454 | 49,114 |
| Cash flows from investing activities: | | |
| Capital expenditures for property, plant and equipment | (6,029) | (6,372) |
| Capital expenditures for intangible assets | (439) | (151) |
| Net cash used in investing activities | (6,468) | (6,523) |
| Cash flows from financing activities: | | |
| Net proceeds from issuance of common shares | 2,143 | 6,641 |
| Repayments of long-term debt | | (3,750) |
| (Repayment of) proceeds from bank borrowings, net | (15) | 69 |
| Changes in restricted cash | (8,141) | (32,271) |
| Excess income tax benefit on employee stock-based awards | 78 | 242 |
| Net cash used in financing activities | (5,935) | (29,069) |
| Effect of exchange rate changes on cash | (431) | 324 |
| Net increase in cash and cash equivalents | 2,620 | 13,846 |
| Cash and cash equivalents at the beginning of the period | 31,055 | 33,207 |
| Cash and cash equivalents at the end of the period | \$ 33,675 | \$ 47,053 |

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

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ORTHOFIX INTERNATIONAL N.V.

Notes to the Unaudited Condensed Consolidated Financial Statements

1. Summary of significant accounting policies

(a) Basis of presentation

The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Pursuant to these rules and regulations, certain information and note disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S., have been condensed or omitted. 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 months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. For further information, refer to the Consolidated Financial Statements and Notes thereto of the Company's Annual Report on Form 10-K, for the fiscal year ended December 31, 2012. The notes to the unaudited condensed consolidated financial statements are presented on a continuing operations basis unless otherwise noted.

(b) Reclassifications

The Company has reclassified certain line items to conform to the current year presentation. The reclassifications have no effect on previously reported net earnings or shareholders' equity.

(c) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, the Company evaluates its estimates including those related to the resolution of U.S. government matters, contractual allowances, doubtful accounts, inventories, taxes, shared-based compensation, and potential goodwill and intangible asset impairment. Actual results could differ from these estimates.

(d) Foreign Currency Translation

The financial statements for operations outside the United States are generally maintained in their local currency. All foreign currency denominated balance sheet accounts, except shareholders' equity, are translated to U.S. dollars at year end exchange rates and revenue and expense items are translated at weighted average rates of exchange prevailing during the year. Gains and losses resulting from the translation of foreign currency are recorded in the accumulated other comprehensive income component of shareholders' equity.

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****2. Inventories**

Inventories are valued at the lower of cost or estimated net realizable value, after provision for excess or obsolete items. For inventory procured or produced, whether internally or through contract manufacturing arrangements, at our manufacturing facility in Italy, cost is determined on a weighted-average basis, which approximates the first in, first out method. For inventory procured or produced, whether internally or through contract manufacturing arrangements, at our manufacturing facility in Texas, standard costs, which approximates actual cost, is used to value inventory. Standard costs are reviewed annually by management, or more often in the event circumstances indicate a change in cost has occurred. The valuation of work-in-process, finished products, field inventory and consignment inventory includes the cost of materials, labor and production costs. Field inventory represents immediately saleable finished products inventory that is in the possession of the Company's direct sales representatives. Consignment inventory represents immediately saleable finished products located at third party customers, such as distributors and hospitals.

| (US\$ in thousands) | March 31, 2013 | December 31, 2012 |
|-----------------------|-------------------|----------------------|
| Raw materials | \$ 6,354 | \$ 8,470 |
| Work-in-process | 7,401 | 7,886 |
| Finished products | 42,834 | 36,675 |
| Field inventory | 29,891 | 29,363 |
| Consignment inventory | 5,653 | 6,350 |
| | \$ 92,133 | \$ 88,744 |

3. Patents and other intangible assets

| (US\$ in thousands) | March 31, 2013 | December 31, 2012 |
|---|-------------------|----------------------|
| Cost | | |
| Patents | \$ 37,992 | \$ 37,695 |
| Trademarks - definite lived | 679 | 657 |
| | 38,671 | 38,352 |
| Accumulated amortization | | |
| Patents | (31,452) | (31,045) |
| Trademarks - definite lived | (454) | (427) |
| | (31,906) | (31,472) |
| Patents and other intangible assets, net | \$ 6,765 | \$ 6,880 |

4. Goodwill

The following table presents the changes in the net carrying value of goodwill:

| (US\$ in thousands) | Total |
|----------------------|-----------|
| At December 31, 2012 | \$ 74,388 |

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Foreign currency (1,781)

At March 31, 2013 \$ 72,607

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****5. Bank borrowings**

Borrowings under lines of credit consist of borrowings in Euros used to fund international operations. There were no borrowings under such facilities at March 31, 2013 and \$0.1 million at December 31, 2012. The weighted average interest rates on borrowings under the line of credit at December 31, 2012 was 3.70%.

The Company had an unused available line of credit of 5.8 million (\$7.4 million) and 5.8 million (\$7.6 million) at March 31, 2013 and December 31, 2012, respectively, in its Italian line of credit. This line of credit provides the Company the option to borrow amounts in Italy at rates which are determined at the time of borrowing. This line of credit is unsecured.

6. Long-term debt

On August 30, 2010, the Company's wholly-owned U.S. holding company, Orthofix Holdings, Inc. (Orthofix Holdings) entered into a Credit Agreement (the Credit Agreement) with certain domestic direct and indirect subsidiaries of the Company (the Guarantors), JPMorgan Chase Bank, N.A., as Administrative Agent, RBS Citizens, N.A., as Syndication Agent, and certain lender parties thereto.

The Credit Agreement provides for a five year, \$200.0 million secured revolving credit facility (the Revolving Credit Facility), and a five year, \$100.0 million secured term loan facility (the Term Loan Facility), and together with the Revolving Credit Facility, the Credit Facilities). Orthofix Holdings has the ability to increase the amount of the Credit Facilities by an aggregate amount of up to \$50.0 million upon satisfaction of certain conditions.

In May 2012, the Company used a portion of the proceeds from the sale of Breg, Inc. (Breg) (see Note 15) to repay in full the remaining \$87.5 million balance on the Term Loan Facility and pay down \$57.5 million of amounts outstanding under the Revolving Credit Facility. This use of proceeds was required by the lenders' consent dated April 23, 2012 to the Credit Agreement. As a result of the sale of Breg, Breg ceased to be a subsidiary of the Company and, therefore, Breg was released as a credit party under the Credit Agreement. Additionally, the Company paid \$20 million in June 2012 and \$20 million in September 2012 to reduce amounts outstanding under the Revolving Credit Facility. As a result, at December 31, 2012, the Term Loan Facility had been repaid in full and there was \$20 million outstanding under the Revolving Credit Facility as of March 31, 2013 and December 31, 2012. Borrowings under the Credit Facilities bear interest at a floating rate, which is, at Orthofix Holdings option, either the London Inter-Bank Offered Rate (LIBOR) plus an applicable margin or a base rate (as defined in the Credit Agreement) plus an applicable margin (in each case subject to adjustment based on financial ratios). Such applicable margin will be up to 3.25% for LIBOR borrowings and up to 2.25% for base rate borrowings depending upon a measurement of the consolidated leverage ratio with respect to the immediately preceding four fiscal quarters. As of March 31, 2013 and December 31, 2012, the entire Revolving Credit Facility was at the LIBOR rate plus a margin of 2.50%. The effective interest rate on the Credit Facilities as of March 31, 2013 and December 31, 2012 was 2.7%.

Outstanding balances on the Revolving Credit Facility are due on August 30, 2015.

Borrowings under the Revolving Credit Facility, which may be made in the future, will be used for working capital, capital expenditures and other general corporate purposes of Orthofix Holdings and its subsidiaries. The Guarantors have guaranteed repayment of Orthofix Holdings obligations under the Credit Agreement. The obligations of Orthofix Holdings and each of the Guarantors with respect to the Credit Facilities are secured by a pledge of substantially all of the assets of Orthofix Holdings and each of the Guarantors.

The Credit Agreement, as amended, requires Orthofix Holdings and the Company to comply with coverage ratios on a consolidated basis and contains affirmative and negative covenants, including limitations on additional debt, liens, investments and acquisitions. The Credit Agreement, as amended, also includes events of default customary for facilities of this type. Upon the occurrence of an event of default, all outstanding loans may be accelerated and/or the lenders' commitments terminated. The Company was in compliance with the affirmative and negative covenants at March 31, 2013 and there were no events of default.

Certain subsidiaries of the Company have restrictions on their ability to pay dividends or make intercompany loan advances pursuant to the Company's Credit Facilities. The net assets of Orthofix Holdings and its subsidiaries are restricted for distributions to the parent company. Domestic subsidiaries of the Company, as parties to the credit agreement, have access to these net assets for operational purposes.

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)**

The amount of restricted net assets of Orthofix Holdings and its subsidiaries as of March 31, 2013 and December 31, 2012 is \$256 million and \$247.4 million, respectively. In addition, the Credit Agreement restricts the Company and subsidiaries that are not parties to the Credit Facilities from access to cash held by Orthofix Holdings, Inc. and its subsidiaries. All of the Company's subsidiaries that are parties to the Credit Agreement have access to this cash for operational and debt repayment purposes. The amount of restricted cash of the Company as of March 31, 2013 and December 31, 2012 was \$29.4 million and \$21.3 million, respectively.

In conjunction with obtaining the Credit Facilities and the Credit Agreement, as amended, the Company incurred debt issuance costs of \$5 million. These costs are being amortized using the effective interest method over the life of the Credit Facilities. In conjunction with the Term Loan Facility repayment in May 2012, the Company wrote off \$0.8 million of related debt issuance costs. As of March 31, 2013 and December 31, 2012, debt issuance costs, net of accumulated amortization, related to the Credit Agreement were \$1.6 million and \$1.8 million, respectively.

7. Derivative instruments

The tables below disclose the types of derivative instruments the Company owns, the classifications and fair values of these instruments within the balance sheet, and the amount of gain (loss) recognized in other comprehensive income (loss) or net income (loss).

(US\$ in thousands)

| As of March 31, 2013 | Fair value: favorable (unfavorable) | Balance sheet location |
|----------------------|--|------------------------|
| Cross-currency swap | \$ 1,598 | Other long-term assets |

As of December 31, 2012

| | | |
|---------------------|--------|------------------------|
| Cross-currency swap | \$ 305 | Other long-term assets |
|---------------------|--------|------------------------|

(US\$ in thousands)

| | Three Months Ended March 31, | |
|--|---------------------------------|--------|
| | 2013 | 2012 |
| Cross-currency swap unrealized gain (loss) recorded in other comprehensive income (loss), net of taxes | \$ (318) | \$ 509 |

Cross-currency swap

On September 30, 2010, the Company entered into a cross-currency swap agreement (the replacement swap agreement) with JPMorgan Chase Bank and Royal Bank of Scotland PLC (the counterparties) to manage its cash flows related to foreign currency exposure for a portion of the Company's intercompany receivable of a U.S. dollar functional currency subsidiary that is denominated in Euro.

Under the terms of the swap agreement, the Company pays Euros based on a 28.7 million notional value and a fixed rate of 5.00% and receives U.S. dollars based on a notional value of \$39 million and a fixed rate of 4.635%. The expiration date is December 30, 2016, the date upon which the underlying intercompany debt, to which the swap agreement applies, matures. The swap agreement is designated as a cash flow hedge and therefore the Company recognized an unrealized gain (loss) on the change in fair value, net of tax, within other comprehensive income (loss).

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****8. Fair value measurements**

Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Non-financial assets and liabilities of the Company measured at fair value include any long-lived assets or equity method investments that are impaired in a currently reported period. The authoritative guidance also describes three levels of inputs that may be used to measure fair value:

- Level 1 quoted prices in active markets for identical assets and liabilities

- Level 2 observable inputs other than quoted prices in active markets for identical assets and liabilities

- Level 3 unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions

As of March 31, 2013, the Company's financial instruments included cash equivalents, restricted cash, accounts receivable, short-term bank borrowings, accounts payable, long-term secured debt, and a cross currency derivative contract. Cash equivalents consist of short-term, highly liquid, income-producing investments, all of which have original maturities of 90 days or less, including money market funds. The carrying value of restricted cash, accounts receivable, short-term bank borrowings and accounts payable approximate fair value due to the short-term maturities of these instruments. The Company's credit facilities carry a floating rate of interest, and therefore, the carrying value is considered to approximate the fair value.

The Company's cross-currency derivative instrument is the only financial instrument recorded at fair value on a recurring basis. This instrument consists of an over-the-counter contract, which is not traded on a public exchange. The fair value of the swap contract is determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized the swap contract as a Level 2 derivative financial instrument. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. The Company has consistently applied these valuation techniques in all periods presented.

The fair value of the Company's financial assets and liabilities on a recurring basis were as follows:

| (US\$ in thousands) | Balance March 31, 2013 | Level 1 | Level 2 | Level 3 |
|----------------------------------|--|----------------|----------------|----------------|
| Derivative financial instruments | | | | |
| Cash flow hedges | | | | |
| Cross-currency hedge | \$ 1,598 | \$ | \$ 1,598 | \$ |
| | | | | |
| (US\$ in thousands) | Balance December 31, 2012 | Level 1 | Level 2 | Level 3 |
| Derivative financial instruments | | | | |
| Cash flow hedges | | | | |
| Cross currency hedge | \$ 305 | \$ | \$ 305 | \$ |

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****9. Comprehensive income (loss)**

Accumulated other comprehensive income is comprised of foreign currency translation adjustments and the effective portion of the gain (loss) on the Company's cross-currency swap, which is designated and accounted for as a cash flow hedge. The components of and changes in accumulated other comprehensive income were as follows:

| (US\$ in thousands) | Foreign Currency Translation Adjustments | Fair Value of Cross-Currency Swap | Accumulated Other Comprehensive Income |
|---|---|---|---|
| Balance at December 31, 2012 | \$ 2,373 | \$ 131 | \$ 2,504 |
| Unrealized gain on cross-currency swap, net of tax of \$187 | | (318) | (318) |
| Foreign currency translation adjustment (1) | (2,814) | | (2,814) |
| Balance at March 31, 2013 | \$ (441) | \$ (187) | \$ (628) |

- (1) As the cash generally remains permanently invested in the non-U.S. dollar denominated foreign subsidiaries, no deferred taxes are recognized on the related foreign currency translation adjustment.

10. Earnings per share

For the three months ended March 31, 2013 and 2012, there were no adjustments to net income for purposes of calculating basic and diluted net income available to common shareholders. The following is a reconciliation of the weighted average shares used in the basic and diluted net income per common share computations.

| | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2013 | 2012 |
| Weighted average common shares-basic | 19,431,093 | 18,675,694 |
| Effect of dilutive securities: | | |
| Unexercised stock options net of treasury share repurchase | 260,048 | 440,501 |
| Weighted average common shares-diluted | 19,691,141 | 19,116,195 |

Options to purchase shares of common stock with exercise prices in excess of the average market price of common shares are not included in the computation of diluted earnings per share. There were 973,037 and 714,686 outstanding options not included in the diluted earnings per share computation for the three months ended March 31, 2013 and 2012, respectively, because the inclusion of these options was anti-dilutive.

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****11. Share-based compensation**

All share-based compensation costs are measured at the grant date, based on the estimated fair value of the award, and are recognized as expense in the condensed consolidated statements of operations over the requisite service period.

The following table shows the detail of share-based compensation by line item in the condensed consolidated statements of operations:

| (US\$ in thousands) | Three Months Ended March 31, | |
|----------------------------|---------------------------------|-----------------|
| | 2013 | 2012 |
| Cost of sales | \$ 287 | \$ 176 |
| Sales and marketing | 436 | 445 |
| General and administrative | 1,175 | 770 |
| Research and development | 45 | 42 |
| Total | \$ 1,943 | \$ 1,433 |

For the three months ended March 31, 2013 and 2012, there were no performance requirements for share-based compensation awarded to employees. In March 2013, the Company granted options to its newly-appointed Chief Executive Officer, which vesting is based on achieving certain market prices for the Company's common stock.

During the three months ended March 31, 2013 and 2012, there were 113,965 and 262,713 shares, respectively, of common stock issued related to stock purchase plan issuances, stock option exercises and the vesting of restricted stock awards.

12. Other income (expense)

The following table shows the detail of other income (expense):

| (US\$ in thousands) | Three Months Ended March 31, | |
|---|---------------------------------|-----------------|
| | 2013 | 2012 |
| Gain related to demutualization of a mutual insurance company (1) | \$ 4,406 | \$ |
| Transactional foreign currency exchange gains (losses) | 623 | (470) |
| Other | (265) | (161) |
| Total | \$ 4,764 | \$ (631) |

(1) In the first quarter of 2013, the Company received \$4.4 million of cash related to the demutualization of a mutual insurance company, in which the company was an eligible member to share in such proceeds.

13. Income taxes

The Company recognized a \$3.3 million and \$7.4 million provision for income tax which reflects an effective tax rate of 40.4% and 37.6% on pre-tax income for the three months ended March 31, 2013 and 2012, respectively. Excluding the impact of various discrete charges, the effective tax rate on continuing operations was 37% for the first three months of 2013 and 2012. The principal factors affecting the Company's effective tax rate was the Company's mix of earnings among various tax jurisdictions, state taxes and current period losses in certain jurisdictions

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for which the Company does not currently provide a tax benefit.

On January 2, 2013, the American Taxpayer Relief Act of 2012 (Act) was enacted. The Act provides tax relief for businesses by reinstating certain tax benefits and credits retroactively to January 1, 2012. There are several provisions of the Act that impact the Company, most notably the extension of the Research and Development credit. Income tax accounting rules require tax law changes to be recognized in the period of enactment; as such, the associated tax benefits of the Act was recognized in the Company s provision for income taxes in the first quarter of 2013.

As of March 31, 2013 and December 31, 2012, the Company s gross unrecognized tax benefit was \$0.7 million and \$1.0 million, respectively. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. In March 2013 the Company settled a \$0.9 million liability that had been previously accrued as of December 31, 2012. The entire amount of unrecognized tax benefits, including interest, would favorably impact the Company s effective tax rate if recognized. As of March 31, 2013, the Company does not expect the amount of unrecognized tax benefits to change significantly over the next twelve months.

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****14. Business segment information**

The Company's segment information (as provided below) has been prepared based on the Company's two global business units (GBU) reporting segments, Spine and Orthopedics. The accounting policies of the segments are the same as those described in the business segment information found in Note 12 to the Consolidated Financial Statements included in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2012.

The table below presents external net sales by GBU reporting segment. Net sales include product sales and marketing service fees. Marketing service fees, which are recorded on a net basis, are comprised of sales of Trinity Evolution® in spine and orthopedic applications.

| (US\$ in thousands) | External Net Sales by GBU Three Months Ended March 31, | | | |
|--|---|------------|---------------------|---------------------------------|
| | 2013 | 2012 | Reported Decline | Constant Currency Decline |
| Spine | | | | |
| Spine Repair Implants and Regenerative Biologics | \$ 34,297 | \$ 35,757 | (4)% | (4)% |
| Spine Regenerative Stimulation | 32,029 | 39,271 | (18)% | (18)% |
| Total Spine | 66,326 | 75,028 | (12)% | (12)% |
| Orthopedics | 33,928 | 41,014 | (17)% | (16)% |
| Total Net Sales | \$ 100,254 | \$ 116,042 | (14)% | (13)% |

The table below presents operating income (loss) by GBU reporting segment:

| Operating Income (Loss) by GBU (US\$ in thousands) | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2013 | 2012 |
| Spine | \$ 11,845 | \$ 21,566 |
| Orthopedics | 958 | 4,979 |
| Corporate (1) | (8,779) | (4,114) |
| Total | \$ 4,024 | \$ 22,431 |

(1) For the three months ended March 31, 2013, the operating loss for Corporate included \$3.6 million of management succession charges.

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Notes to the Unaudited Condensed Consolidated Financial Statements (continued)

15. Sale of Breg and Disposition of Sports Medicine GBU

On April 23, 2012, the Company's subsidiary Orthofix Holdings and Breg entered into a stock purchase agreement (the "SPA") with Breg Acquisition Corp. ("Buyer"), a newly formed affiliate of Water Street Healthcare Partners II, L.P., pursuant to which Buyer agreed to acquire from Orthofix Holdings all the outstanding shares of Breg, subject to the terms and conditions contained therein (the "Transaction"). Under the terms of the SPA, upon closing of the sale, Orthofix Holdings and the Company agreed to indemnify Buyer with respect to certain specified matters, including the government investigation and product liability matters regarding a previously owned infusion pump product line, and pre-closing sales of cold therapy units and certain post-closing sales of cold therapy units. (See "Matters Related to the Company's former Breg Subsidiary and Possible Indemnification Obligations under Note 16.") On May 24, 2012 (the "Closing Date"), Orthofix Holdings completed the sale of all of the outstanding shares of Breg for \$157.5 million in cash. After adjustments for working capital and indebtedness in accordance with the terms of the SPA, Orthofix Holdings used \$145 million of the net proceeds to prepay outstanding Company indebtedness, as required by a lender consent received in connection with the Company's existing Credit Agreement. As a result of the closing of this Transaction, Breg ceased to be a subsidiary of the Company and, therefore, Breg was released as a credit party under the Credit Agreement. The Company also agreed to enter into certain transition arrangements at the closing, including a transition services agreement pursuant to which the Company agreed to continue to provide administrative operational support for a period of up to twelve months. As a result of the sale of Breg, the Company completed its exit from the Sports Medicine GBU, of which Breg was a significant component.

The portion of indemnification related to post closing claims related to post-closing sales of cold therapy has created a guarantee under Accounting Standards Codification ASC 460 *Guarantees* and the fair value of the liability has been recorded under the initial recognition criteria in the amount of \$2 million at the Closing Date of the transaction. The Company will amortize the fair value of the noncontingent liability ratably over the period of indemnification which is three years. The Company's obligations under this guarantee were approximately \$1.4 million and \$1.6 million as of March 31, 2013 and December 31, 2012, respectively.

Table of Contents**Notes to the Unaudited Condensed Consolidated Financial Statements (continued)****Gain on Sale of Discontinued Operations**

The following table presents the value of the asset disposition, proceeds received, net of various working capital adjustments and indebtedness and net gain on sale of Breg as shown in the condensed consolidated statement of operations for the year ended December 31, 2012.

| (US\$ in thousands) | Total |
|------------------------------------|--------------|
| Cash proceeds | \$ 157,500 |
| Less: | |
| Working Capital | (7,093) |
| Transaction related expenses | (4,276) |
| Fair Value of Indemnification | (2,000) |
| Tangible assets | (8,309) |
| Intangible assets | (28,164) |
| Goodwill | (106,200) |
| | |
| Gain on sale of Breg | 1,458 |
| Income tax expense | (113) |
| | |
| Gain on sale of Breg, net of taxes | \$ 1,345 |

The Sports Medicine GBU contributed \$27.1 million of net sales in the three months ended March 31, 2012. The Sports Medicine GBU had \$0.4 million of operating loss in the three months ended March 31, 2012. The financial information above includes the financial results of Breg operations up to the date of sale.

Included in discontinued operations for the three months ended March 31, 2013 is \$4 million of expense related to the Company's indemnification of certain specified matters described above.

The Company's consolidated financial statements and related footnote disclosures reflect the Sports Medicine GBU as discontinued operations. Income (loss) associated with the Sports Medicine GBU, net of applicable income taxes is shown as income (loss) from discontinued operations for all periods presented in accordance with *ASC 205-20 Discontinued Operations*.

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Notes to the Unaudited Condensed Consolidated Financial Statements (continued)

16. Contingencies

The Company is a party to certain outstanding legal proceedings, investigations and claims. These matters are described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Material recent developments regarding such matters are described below.

The Company believes that it is unlikely that the outcome of any or all of these matters will have a material adverse effect on the Company and its subsidiaries as a whole, notwithstanding that the unfavorable resolution of any matter may have a material effect on the Company's net earnings (if any) in any particular quarter. However, the Company cannot predict with any certainty the final outcome of any legal proceedings, investigations or claims made against it or its subsidiaries described in the paragraphs below, and there can be no assurance that the ultimate resolution of any such matter will not have a material adverse impact on the Company's consolidated financial position, results of operations, or cash flows.

The Company records accruals for certain of its outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of the loss can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal proceedings, investigations and claims that could affect the amount of any accrual, as well as any developments that would make a loss contingency both probable and reasonably estimable. When a loss contingency is not both probable and reasonably estimable, the Company does not accrue the loss. However, if the loss (or an additional loss in excess of the accrual) is at least a reasonable possibility and material, then the Company discloses a reasonable estimate of the possible loss or range of loss, if such reasonable estimate can be made. If the Company cannot make a reasonable estimate of the possible loss, or range of loss, then that is disclosed.

The assessments of whether a loss is probable or a reasonable possibility, and whether the loss or range of loss is reasonably estimable, often involve a series of complex judgments about future events. Among the factors that the Company considers in this assessment are the nature of existing legal proceedings, investigations and claims, the asserted or possible damages or loss contingency (if reasonably estimable), the progress of the matter, existing law and precedent, the opinions or views of legal counsel and other advisers, the involvement of the U.S. Government and its agencies in such proceedings, the Company's experience in similar matters and the experience of other companies, the facts available to the Company at the time of assessment, and how the Company intends to respond, or has responded, to the proceeding, investigation or claim. The Company's assessment of these factors may change over time as individual proceedings, investigations or claims progress. For matters where the Company is not currently able to reasonably estimate a range of reasonably possible loss, the factors that have contributed to this determination include the following: (i) the damages sought are indeterminate, or an investigation has not manifested itself in a filed civil or criminal complaint, (ii) the matters are in the early stages, (iii) the matters involve novel or unsettled legal theories or a large or uncertain number of actual or potential cases or parties, and/or (iv) discussions with the government or other parties in matters that may be expected ultimately to be resolved through negotiation and settlement have not reached the point where the Company believes a reasonable estimate of loss, or range of loss, can be made. In such instances, the Company believes that there is considerable uncertainty regarding the timing or ultimate resolution of such matters, including a possible eventual loss, fine, penalty or business impact, if any.

In addition to the matters specifically identified in the paragraphs below, in the normal course of our business, the Company is involved in various lawsuits from time to time and may be subject to certain other contingencies. To the extent losses related to these contingencies are both probable and reasonably estimable, the Company accrues appropriate amounts in the accompanying financial statements and provides disclosures as to the possible range of loss in excess of the amount accrued, if such range is reasonably estimable. The Company believes losses are individually and collectively immaterial as to a possible loss and range of loss.

17. Subsequent Event

On May 8, 2013, the Company announced that its Board of Directors has authorized a share repurchase program in an amount up to \$50 million. Repurchases are expected to consist primarily of open market transactions at prevailing market prices in accordance with the guidelines specified under Rule 10b-18 of the Securities Exchange Act of 1934, as amended, though the Company may also make repurchases through block trades or privately negotiated transactions. The Company expects that repurchases will begin on or about May 10, 2013. Repurchases are expected to be made from cash on hand, cash generated from operations, and additional borrowings. The timing of the transactions and the aggregate number of shares of common stock that will be repurchased under the repurchase program will depend on a variety of factors, including market conditions and the prices at which the securities are repurchased. The Company may discontinue repurchases without prior notice at any time if it determines additional repurchases are not warranted.

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Litigation Matter Updates:

Matters Related to the Company's Former Breg Subsidiary and Possible Indemnification Obligations

On May 24, 2012, the Company sold Breg, Inc. ("Breg") to an affiliate of Water Street Healthcare Partners II, L.P. ("Water Street") pursuant to a stock purchase agreement (the "Breg SPA"). Under the terms of the Breg SPA, upon closing of the sale, the Company and its subsidiary, Orthofix Holdings, Inc., agreed to indemnify Water Street and Breg with respect to certain specified matters, including (i) the government investigation and product liability matters regarding the previously owned infusion pump product line described below, and (ii) pre-closing sales of cold therapy units and certain post-closing sales of cold therapy units. The Company has established an accrual of \$4.2 million for its indemnification obligations in connection with the July 2012 verdict described in the paragraph below, however, actual liability in this case could be higher or lower than the amount accrued. The Company has not established any accrual in connection with its other indemnification obligations under the Breg SPA, and currently cannot reasonably estimate the possible loss, or range of loss, in connection with such obligations (including with respect to the matters described in the paragraphs below).

Breg was engaged in the manufacturing and sale of local infusion pumps for pain management from 1999 to 2008. Since 2008, numerous product liability cases have been filed in the United States alleging that the local anesthetic, when dispensed by such infusion pumps inside a joint, causes a rare arthritic condition called chondrolysis. The Company believes that meritorious defenses exist to these claims and Breg is vigorously defending these cases. One of the Company's insurance carriers previously asserted to the Company that certain potential losses related to this matter are not covered by its insurance coverage. The Company subsequently went into arbitration with this carrier, and on January 22, 2013, the Company obtained a binding arbitration award providing that such carrier is obligated to reimburse the Company for defense expenses, settlements, and judgments under certain policies. The Company currently estimates that it is entitled to reimbursement of approximately \$13 million for past losses incurred, as well as up to \$15 million in potential future coverage for pending products liability matters.

On or about August 2, 2010, Breg received a HIPAA subpoena issued by the Department of Justice ("DOJ"). The subpoena seeks documents from the Company and its subsidiaries for the period of January 1, 2000 through the date of the subpoena. The Company believes that document production in response to the subpoena is completed as of July 2012. DOJ has informed the Company that it is investigating possible criminal and civil violations of federal law related to Breg's sale, marketing and labeling of local infusion pumps for pain management, prior to Breg's divestiture of this product line in 2008. The Company is currently cooperating with the U.S. Government in connection with this matter.

On January 27, 2012, the Company was orally notified by a U.S. Government official that a civil investigation of Breg was pending in connection with this matter. On January 18, 2013, the Company was served with a qui tam complaint filed in the United States District Court for the Western District of Missouri against the Company (as the former owner of Breg), Stryker Corporation, I-Flow Corporation and DJO Incorporated, which contains allegations relating to the marketing and promotion of Breg's former infusion pump products. The Company is vigorously defending this matter.

At the time of its divestiture by the Company, Breg was engaged and had been engaged in the manufacturing and sales of motorized cold therapy units used to reduce pain and swelling. Several domestic product liability cases have been filed in recent years, mostly in California state court, alleging that the use of cold therapy causes skin and/or nerve injury and seeking damages on behalf of individual plaintiffs who were allegedly injured by such units. The majority of these cases are at an early stage and no conclusion can be drawn at the present time regarding their potential outcome. However, the Company believes that meritorious defenses exist to these claims. In July 2012, a jury in one case related to a motorized cold therapy unit previously sold by Breg returned a verdict providing for approximately \$2.1 million in compensatory damages to the plaintiff against Breg and \$7 million in exemplary damages. The case remains subject to appeal. The Company believes that the damages are without merit; however, the ultimate outcome is uncertain. The Company previously established an accrual of \$4.2 million for both compensatory damages and exemplary damages for its indemnification obligations in connection with this July 2012 verdict; however, actual liability in this case could be higher or lower than the amount accrued.

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

The following discussion and analysis addresses the results of our operations which are based upon the consolidated financial statements included herein, which have been prepared in accordance with US GAAP, for the three months ended March 31, 2013 compared to the three months ended March 31, 2012. These discussions should be read in conjunction with our historical consolidated financial statements and related notes thereto and the other financial information included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

General Overview

We are a diversified, global medical device company focused on developing and delivering innovative repair and regenerative solutions to the spine and orthopedic markets. Our products are designed to address the lifelong bone-and-joint health needs of patients of all ages, helping them achieve a more active and mobile lifestyle. We design, develop, manufacture, market and distribute medical equipment used principally by musculoskeletal medical specialists for orthopedic applications. Our main products are invasive and minimally invasive spinal implant products and related human cellular and tissue based products (HCT/P products), non-invasive regenerative stimulation products used to enhance bone growth and the success rate of spinal fusions and to treat non-union fractures, external and internal fixation devices used in fracture repair, limb lengthening and bone reconstruction. Our products also include bone cement and devices for removal of bone cement used to fix artificial implants.

We have administrative and training facilities in the United States (U.S.), Brazil and Italy and manufacturing facilities in the U.S., the United Kingdom, and Italy. The Spine global business unit (GBU) directly distributes products in the U.S. The orthopedics GBU directly distributes products in the U.S., the United Kingdom, Italy, Germany, Switzerland, Austria, France, Belgium, Brazil and Puerto Rico. In several of these and other markets we also distribute our products through independent distributors.

Our condensed consolidated financial statements include the financial results of our Company and our wholly-owned and majority-owned subsidiaries and entities over which we have control. All intercompany accounts and transactions are eliminated in consolidation.

Our reporting currency is the U.S. Dollar. All balance sheet accounts, except shareholders' equity, are translated at period-end exchange rates and revenue and expense items are translated at weighted average rates of exchange prevailing during the period. Gains and losses resulting from foreign currency transactions are included in other income and expense. Gains and losses resulting from the translation of foreign currency financial statements are recorded in the accumulated other comprehensive income component of shareholders' equity.

Our financial condition, results of operations and cash flows are not significantly impacted by seasonality trends. However, sales associated with products for elective procedures appear to be influenced by the somewhat lower volume of such procedures performed in the late summer. In addition, we do not believe our operations will be significantly affected by inflation. However, in the ordinary course of business, we are exposed to the impact of changes in interest rates and foreign currency fluctuations. Our objective is to limit the impact of such movements on earnings and cash flows. In order to achieve this objective, we seek to balance non-dollar denominated income and expenditures. During the period, we have used derivative instruments to hedge foreign currency fluctuation exposures. See Item 3, *Quantitative and Qualitative Disclosures About Market Risk*.

We manage our business by our two global business units (GBUs), which are comprised of Spine and Orthopedics, supported by our Corporate activities. These GBUs represent the current segments in which our Chief Operating Decision Maker reviews financial information and makes resource allocation decisions among business units. Accordingly, our segment information (as provided below) has been prepared based on our two GBU reporting segments. Corporate activities not necessarily identifiable within the two GBUs are recorded as part of Corporate.

Spine

Spine provides a portfolio of repair and regenerative products that allow physicians to successfully treat a variety of spinal conditions. This global business unit specializes in the design, development and marketing of our spine repair products along with regenerative stimulation and biologics products used in spine applications. Spine distributes its products through a network of distributors, sales representatives and affiliates. This global business unit uses both direct and distributor sales representatives to sell spine products to hospitals, doctors and other healthcare providers, globally.

Table of Contents*Orthopedics*

Orthopedics provides a portfolio of repair and regenerative products that allow physicians to successfully treat a variety of orthopedic conditions unrelated to spine. This global business unit specializes in the design, development and marketing of our orthopedic repair products along with regenerative stimulation and biologics products used in orthopedic applications. Orthopedics distributes its products through a network of distributors, sales representatives and affiliates. This global business unit uses both direct and distributor sales representatives to sell orthopedics products to hospitals, doctors and other healthcare providers, globally.

Corporate

Corporate activities are comprised of the operating expenses of Orthofix International N.V. and its holding company subsidiaries, along with activities not necessarily identifiable with the two GBUs.

GBU Revenues

The following table displays net sales by GBU for the three months ended March 31, 2013 and 2012.

The table below presents external net sales by GBU reporting segment:

| (US\$ in thousands) | External Net Sales by GBU Three Months Ended March 31, | | | |
|--|---|------------|---------------------|---------------------------------|
| | 2013 | 2012 | Reported Decline | Constant Currency Decline |
| Spine | | | | |
| Spine Repair Implants and Regenerative Biologics | \$ 34,297 | \$ 35,757 | (4)% | (4)% |
| Spine Regenerative Stimulation | 32,029 | 39,271 | (18)% | (18)% |
| Total Spine | 66,326 | 75,028 | (12)% | (12)% |
| Orthopedics | 33,928 | 41,014 | (17)% | (16)% |
| Total Net sales | \$ 100,254 | \$ 116,042 | (14)% | (13)% |

Note: Spine Repair Implants and Regenerative Biologics includes \$9.4 million and \$8.7 million of marketing service fees in the three months ended March 31, 2013 and 2012, respectively. Orthopedics includes \$2.5 million of marketing service fees in the three months ended March 31, 2013 and 2012.

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The following table presents certain items in our condensed consolidated statements of operations as a percent of total net sales for the periods indicated:

| | Three Months Ended March 31, | |
|-----------------------------------|---|---------------------|
| | 2013 (%) | 2012 (%) |
| Product sales | 88 | 90 |
| Marketing service fees | 12 | 10 |
| Net sales | 100 | 100 |
| Cost of sales | 23 | 19 |
| Gross profit | 77 | 81 |
| Operating expenses: | | |
| Sales and marketing | 49 | 43 |
| General and administrative | 19 | 13 |
| Research and development | 5 | 6 |
| Amortization of intangible assets | 1 | 0 |
| Operating income | 4 | 19 |
| Net income | 2 | 10 |

Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012

Net sales decreased \$15.7 million to \$100.3 million in the first quarter of 2013 compared to \$116 million for the same period last year. The impact of foreign currency decreased sales by \$0.7 million during the first quarter of 2013 when compared to the first quarter of 2012. Net sales include product sales and marketing service fees which is comprised of sales of Trinity Evolution[®] in spine and orthopedic applications.

Sales

Net sales in our Spine global business unit decreased to \$66.3 million in the first quarter of 2013 compared to \$75.0 million for the same period last year, a decrease of \$8.7 million. The decrease in Spine's net sales was made up of an 18% (or \$7.2 million) decrease in sales of Regenerative Stimulation products used in spine applications and a 4% (or \$1.5 million) decrease in sales of Repair Implants and Regenerative Biologics products when compared to the same period in the prior year. The decrease in sales of Regenerative Stimulation products used in spine applications was primarily a result of residual effects of distribution disruptions and higher than ordinary mix of wholesale revenue in the first quarter of 2012. The decrease in sales of Repair Implants and Regenerative Biologics products was primarily due to weakness in international markets as well as pricing pressures in the U.S. This decline was partially offset by the growth from the ongoing rollout of the FORZA Spinal Spacer System and the increased adoption of Trinity Evolution[®] in spine fusion applications which led to a 7% increase in sales of Trinity Evolution[®] in the first quarter of 2013.

Net sales in our Orthopedics global business unit decreased 17% (or 16% on a constant currency basis) to \$33.9 million in the first quarter of 2013 compared to \$41 million for the same period last year. This decrease was primarily due to continuing challenges in Brazil in Orthopedics Repair, which has been impacted by increased competition and product delays due to the strike at the country's regulatory agency; a 24% decrease of Physio-Stim[®] Regenerative Stimulation sales mainly in the US and in France (where we stopped receiving reimbursement on this product); and poor macroeconomic conditions in Europe.

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Gross Profit Our gross profit decreased \$16.5 million to \$77.6 million in the first quarter of 2013, compared to \$94.1 million for the same period last year. Gross profit as a percent of net sales in the first quarter of 2013 was 77% compared to 81% for the same period last year. The decrease in the gross profit margin is primarily a result of an unfavorable product and geographical sales mix relating to the decrease in our stimulation sales both in Spine and Orthopedics, impacts from pricing challenges in our Spine Implants business and an increase in depreciation expense related to new product launches in our Spine Implants business that took place in the third and fourth quarters of 2012.

Sales and Marketing Expense Sales and marketing expense, which includes commissions certain royalties and the bad debt provision, generally increase and decrease in relation to sales. Sales and marketing expense decreased \$0.7 million, to \$48.8 million in the first quarter of 2013 compared to \$49.5 million in the first quarter of 2012. As a percent of net sales, sales and marketing expense was 49% and 43% in the first quarter of 2013 and 2012, respectively. The increase as a percent of sales was driven primarily by the impact of lower sales on non-variable sales and marketing expense, which included the non-variable component of the bad debt provision and commission costs associated with our sales force mix. From time to time the bad debt provision is impacted by a change in reserves based on management's assessment of recent economic conditions on certain customer accounts receivable balances.

General and Administrative Expense General and administrative expense increased \$4.2 million, or 29%, in the first quarter of 2013 to \$18.8 million compared to \$14.6 million in the first quarter of 2012. The first quarter of 2013 included \$3.6 million of senior management succession charges. Excluding these succession charges, general and administrative expense as a percent of net sales was 15% in the first quarter of 2013 compared to 13% for the same period last year. This increase as a percent of sales was driven primarily by the impact of lower sales on non-variable general and administrative expense and to a lesser extent the impact of the medical device excise tax (effective January 1, 2013) which we record in general and administrative expense.

Research and Development Expense Research and development expense decreased \$1.7 million in the first quarter of 2013 to \$5.4 million compared to \$7.1 million for the same period last year. As a percent of sales, research and development expense was 5% in the first quarter of 2013 compared to 6% for the same period last year. The decrease in research and development expenses in the first quarter of 2013 compared to the same period in the prior year was due to our strategic investment with Musculoskeletal Transplant Foundation (MTF) of \$1 million in the 2012 period on the development and commercialization of the next generation cell-based bone growth technology and timing of spending related to our ongoing research, development and clinical activities.

Amortization of Intangible Assets Amortization of intangible assets was \$0.5 million in the first quarter of 2013 and 2012.

Interest Expense, net Interest expense, net was \$0.6 million for the first quarter of 2013 compared to \$2.2 million for the same period last year, primarily as the result of a lower year over year outstanding debt balance and to a lesser extent lower interest rates.

Other Income (Expense) Other income (expense) was \$4.8 million and \$(0.6) million for the first quarters of 2013 and 2012, respectively. The fluctuation is mainly attributable to our receipt of \$4.4 million cash related to the demutualization of a mutual insurance company in which we were an eligible member to share in such proceeds. Other income (expense) also includes the effect of foreign exchange. Several of our foreign subsidiaries hold trade payables or receivables in currencies (most notably the U.S. Dollar) other than their functional (local) currency which results in foreign exchange gains or losses when there is relative movement between those currencies.

Income Tax Expense Our worldwide effective tax rate was 40.4% and 37.6% during the first quarters of 2013 and 2012, respectively. When adjusted for various discrete items, the effective tax rate for the first quarter of 2013 and 2012 was 37%. These rates are affected by the mix of earnings among various tax jurisdictions and losses incurred in a number of foreign jurisdictions, for which we do not currently recognize a tax benefit. We do not believe that it is more likely than not that we will generate sufficient future income in these jurisdictions to allow for the utilization of these losses before their expiration.

Net Income Net income for the first quarter of 2013 was \$2.1 million, or \$0.11 per basic and \$0.11 per diluted share, compared to net income of \$12 million, or \$0.64 per basic and \$0.63 per diluted share for the same period last year.

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Liquidity and Capital Resources

Cash and cash equivalents including Restricted Cash at March 31, 2013 were \$63.1 million, of which \$29.4 million was subject to certain restrictions under the senior secured credit agreement described below. This compares to cash and cash equivalents of \$52.4 million at December 31, 2012, of which \$21.3 million was subject to certain restrictions under the senior secured credit agreement discussed below.

Net cash provided by operating activities was \$15.5 million and \$49.1 million for the three months ended March 31, 2013 and 2012, respectively. Net cash provided by operating activities is comprised of net income, non-cash items (including depreciation and amortization, provision for doubtful accounts, provision for inventory obsolescence, share-based compensation and deferred income taxes) and changes in working capital. Net income decreased \$9.9 million to net income of \$2.1 million for the three months ended March 31, 2013 from a net income of \$12 million for the comparable period in the prior year. Non-cash items for the three months ended March 31, 2013 decreased \$1.7 million to \$10.6 million compared to non-cash items of \$12.3 million in the same period of 2012. Working capital accounts provided \$2.7 million and \$24.8 million of cash for the three months ended March 31, 2013 and 2012, respectively. For the three months ended March 31, 2012, working capital accounts were impacted by \$41.5 million in cash we received from the Blackstone escrow fund which was recorded in Restricted Cash in accordance with the credit facility. Overall performance indicators for our two primary working capital accounts, accounts receivable and inventory reflect days sales in receivables of 119 days at March 31, 2013 and 112 days at March 31, 2012, and inventory turns of 0.9 times as of March 31, 2013 and 1.1 times as of March 31, 2012.

Net cash used by investing activities was \$6.5 million for the three months ended March 31, 2013 and 2012 for capital expenditures.

Net cash used in financing activities was \$5.9 million for the three months ended March 31, 2013 compared to \$29.1 million for the three months ended March 31, 2012. During the three months ended March 31, 2013, we made no repayments on our revolving debt as compared to \$3.8 million during the three months ended March 31, 2012. Our restricted cash balance usage of \$32.3 million in the three months ended March 31, 2012 primarily related to the cash received from the Blackstone escrow fund which was recorded in Restricted Cash in accordance with the credit facility. Our restricted cash balance usage was \$8.1 million in the three months ended March 31, 2013. During the three months ended March 31, 2013 and 2012, we received proceeds of \$2.1 million and \$6.6 million, respectively, from the issuance of 113,965 shares and 262,713 shares, respectively, of our common stock related to stock purchase plan issuances, stock option exercises and the vesting of restricted stock awards.

On August 30, 2010, our wholly-owned U.S. holding company, Orthofix Holdings, Inc. ("Orthofix Holdings") entered into a Credit Agreement (the "Credit Agreement") with certain of our domestic direct and indirect subsidiaries (the "Guarantors"), JPMorgan Chase Bank, N.A., as Administrative Agent, RBS Citizens, N.A., as Syndication Agent, and certain lender parties thereto.

The Credit Agreement provides for a five year, \$200.0 million secured revolving credit facility (the "Revolving Credit Facility"), and a five year, \$100.0 million secured term loan facility (the "Term Loan Facility"), and together with the Revolving Credit Facility, the "Credit Facilities"). Orthofix Holdings has the ability to increase the amount of the Credit Facilities by an aggregate amount of up to \$50 million upon satisfaction of certain conditions.

In May 2012, we used a portion of the proceeds from the sale of Breg, Inc. to repay the \$87.5 million remaining balance on the Term Loan Facility and pay down \$57.5 million of amounts outstanding under the Revolving Credit Facility. This use of proceeds was required by the lenders' consent dated April 23, 2012 to the Credit Agreement. Additionally, we paid \$20 million in June 2012 and \$20 million in September 2012 to reduce amounts outstanding under the Revolving Credit Facility.

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As of March 31, 2013, the Term Loan Facility had been repaid in full and there was \$20 million outstanding under the Revolving Credit Facility. Borrowings under the Credit Facilities bear interest at a floating rate, which is, at Orthofix Holdings' option, either the London Inter-Bank Offered Rate (LIBOR) plus an applicable margin or a base rate (as defined in the Credit Agreement) plus an applicable margin (in each case subject to adjustment based on financial ratios). Such applicable margin will be up to 3.25% for LIBOR borrowings and up to 2.25% for base rate borrowings depending upon a measurement of the consolidated leverage ratio with respect to the immediately preceding four fiscal quarters. As of March 31, 2013 and December 31, 2012, the entire Revolving Credit Facility was at the LIBOR rate plus a margin of 2.50%. The effective interest rate on the Credit Facilities at March 31, 2013 and December 31, 2012 was 2.7%.

Outstanding balances on the Revolving Credit Facility are due on August 30, 2015.

Borrowings under the Revolving Credit Facility, which may be made in the future, will be used for working capital, capital expenditures and other general corporate purposes of Orthofix Holdings and its subsidiaries. The Guarantors have guaranteed repayment of Orthofix Holdings' obligations under the Credit Agreement. The obligations of Orthofix Holdings and each of the Guarantors with respect to the Credit Facilities are secured by a pledge of substantially all of the assets of Orthofix Holdings and each of the Guarantors.

The Credit Agreement as amended requires us and Orthofix Holdings to comply with coverage ratios on a consolidated basis and contains affirmative and negative covenants, including limitations on additional debt, liens, investments and acquisitions. We believe we were in compliance with the affirmative and negative covenants at March 31, 2013 and there were no events of default.

Certain of our subsidiaries have restrictions on their ability to pay dividends or make intercompany loan advances pursuant to the Credit Facilities. The net assets of Orthofix Holdings and its subsidiaries are restricted for distributions to the parent company. Our domestic subsidiaries, as parties to the Credit Agreement, have access to these net assets for operational purposes. The amount of restricted net assets of Orthofix Holdings and its subsidiaries as of March 31, 2013 and December 31, 2012 was \$256 million and \$247.4 million, respectively. In addition, the Credit Agreement restricts us and our subsidiaries that are not parties to the Credit Facilities from access to cash held by Orthofix Holdings and its subsidiaries. The amount of restricted cash as of March 31, 2013 and December 31, 2012 was \$29.4 million and \$21.3 million, respectively.

At March 31, 2013, we had no outstanding bank borrowings and unused available line of credit of approximately 5.8 million (\$7.4 million) under the line of credit established in Italy to finance the working capital of our Italian operations. The terms of the line of credit give us the option to borrow amounts in Italy at rates determined at the time of borrowing.

On May 8, 2013, we announced that our Board of Directors has authorized a share repurchase program in an amount up to \$50 million. Repurchases are expected to consist primarily of open market transactions at prevailing market prices in accordance with the guidelines specified under Rule 10b-18 of the Securities Exchange Act of 1934, as amended, though we may also make repurchases through block trades or privately negotiated transactions. We expect that repurchases will begin on or about May 10, 2013. Repurchases are expected to be made from cash on hand, cash generated from operations, and additional borrowings. The timing of the transactions and the aggregate number of shares of common stock that will be repurchased under the repurchase program will depend on a variety of factors, including market conditions and the prices at which the securities are repurchased. We may discontinue repurchases without prior notice at any time if we determine additional repurchases are not warranted.

We believe that current cash balances together with projected cash flows from operating activities, the availability of the \$180 million revolving credit facility, the available Italian line of credit and our debt capacity are sufficient to cover anticipated working capital and capital expenditure needs including research and development costs over the next twelve months.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks as part of our ongoing business operations. Primary exposures include changes in interest rates and foreign currency fluctuations. These exposures can vary sales, cost of sales, costs of operations and the cost of financing and yields on cash and short-term investments. We use derivative financial instruments, where appropriate, to manage these risks. However, our risk management policy does not allow us to hedge positions we do not hold nor do we enter into derivative or other financial investments for trading or speculative purposes. As of March 31, 2013, we had a currency swap in place to minimize foreign currency exchange risk related to a 28.7 million (\$36.8 million translated at the March 31, 2013 foreign exchange rate) intercompany note. As of March 31, 2013 the fair value of the currency swap was approximately \$1.6 million and is recorded in other long-term assets.

We are exposed to interest rate risk in connection with our Term Loan facility and Revolving Credit Facility, which bear interest at floating rates based on LIBOR plus an applicable borrowing margin or at a base rate (as defined in the Credit Agreement) plus an applicable borrowing margin. Therefore, interest rate changes generally do not affect the fair market value of the debt, but do impact future earnings and cash flows, assuming other factors are held constant.

As of March 31, 2013, \$20 million of the Revolving Credit Facility is at the LIBOR rate plus a margin of 2.50%. The margin is adjusted based upon the measurement of the consolidated leverage ratio of our Company and our subsidiaries with respect to the immediately preceding four fiscal quarters. As of March 31, 2013, our effective interest rate on our Credit Facilities was 2.7%. Based on the balance outstanding under the Credit Facilities as of March 31, 2013, an immediate change of one percentage point in the applicable interest rate on the Revolving Credit Facility would cause a change in interest expense of approximately \$0.2 million annually.

Our foreign currency exposure results from fluctuating currency exchange rates, primarily the U.S. Dollar against the Euro, Great Britain Pound, Mexican Peso and Brazilian Real. We are subject to cost of goods currency exposure when we produce products in foreign currencies such as the Euro or Great Britain Pound and sell those products in U.S. Dollars. We are subject to transactional currency exposures when foreign subsidiaries (or the Company itself) enter into transactions denominated in a currency other than their functional currency. As of March 31, 2013, we had an un-hedged intercompany receivable denominated in Euro of approximately 23.2 million (\$29.7 million). We recorded a foreign currency loss during the three months ended March 31, 2013 of \$0.3 million related to this un-hedged long-term intercompany note in accumulated other comprehensive income during 2013, which resulted from the strengthening of the U.S. dollar against the Euro during the period. For the three months ended March 31, 2013, we recorded a foreign currency gain of \$0.6 million on the statement of operations resulting from gains and losses in foreign currency transactions.

We also are subject to currency exposure from translating the results of our global operations into the U.S. dollar at exchange rates that have fluctuated during the period. As we continue to distribute and manufacture our products in selected foreign countries, we expect that future sales and costs associated with our activities in these markets will continue to be denominated in the applicable foreign currencies, which could cause currency fluctuations to materially impact our operating results.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Chief Financial Officer we performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) or 15d-15(e)) as of the end of the period covered by this Form 10-Q. Based upon that evaluation, our President and Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Form 10-Q, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting during the fiscal quarter ended March 31, 2013 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 16 *Contingencies* to our unaudited condensed consolidated financial statements contained in Item 1, *Financial Statements*, of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

Item 1 A . Risk Factors

There have been no material changes to our risk factors from the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2012.

Item 6. Exhibits

- 10.1 Employment Agreement, entered into as of January 7, 2013, by and between Orthofix Inc. and Emily Buxton (filed as an exhibit to the Company's current report on Form 8-K filed January 11, 2013 and incorporated herein by reference).
- 10.2 Letter Agreement, dated March 12, 2013, between Orthofix Inc., Orthofix International N.V. and Robert S. Vaters (filed as an exhibit to the Company's current report on Form 8-K filed March 13, 2013 and incorporated herein by reference).
- 10.3 Employment Agreement, effective as of March 13, 2013, by and between Orthofix Inc. and Bradley R. Mason (filed as an exhibit to the Company's current report on Form 8-K filed March 13, 2013 and incorporated herein by reference).
- 10.4 Inducement Grant Non-Qualified Stock Option Agreement, dated March 13, 2013, between Orthofix International N.V. and Bradley R. Mason (filed as an exhibit to the Company's current report on Form 8-K filed March 13, 2013 and incorporated herein by reference).
- 10.5 Restricted Stock Grant Agreement under the Orthofix International N.V. 2012 Long-Term Incentive Plan, dated March 13, 2013, between Orthofix International N.V. and Bradley R. Mason (filed as an exhibit to the Company's current report on Form 8-K filed March 13, 2013 and incorporated herein by reference).
- 31.1* Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
- 31.2* Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
- 32.1* Section 1350 Certification of Chief Executive Officer.
- 32.2* Section 1350 Certification of Chief Financial Officer.
- 101* The following materials from the Orthofix International N.V. Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Income (Loss), (iii) Condensed Consolidated Statements of Cash Flows and (iv) related notes, detail tagged.

* Filed herewith.

+ Certain confidential portions of this exhibit were omitted by means of redacting a portion of the text. This exhibit has been filed separately with the Secretary of the Commission without redactions pursuant to our Application Requesting Confidential Treatment under the Securities Exchange Act of 1934.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ORTHOFIX INTERNATIONAL N.V.

Date: May 9, 2013

By: /s/ Bradley R. Mason
Name: Bradley R. Mason
Title: President and Chief Executive Officer

Date: May 9, 2013

By: /s/ Emily V. Buxton
Name: Emily V. Buxton
Title: Chief Financial Officer