NATUS MEDICAL INC
Form 10-Q
May 10, 2007
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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 March 31, 2007

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number: 000-33001

NATUS MEDICAL INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	**77-0154833**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1501 Industrial Road, San Carlos, CA 94070

(Address of principal executive offices) (Zip Code)

(650) 802-0400

(Registrant s telephone number, including area code)

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

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

Large Accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The number of issued and outstanding shares of the registrant s Common Stock, $0.001 par value, as of May 07, 2007, was 21,573,847.

NATUS MEDICAL INCORPORATED

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share amounts)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,784	$ 15,392
Accounts receivable, net of allowance for doubtful accounts of $491 and $552	19,690	20,347
Inventories	13,421	11,743
Prepaid expenses and other current assets	2,271	1,874
Deferred income taxes	2,240	2,240
Total current assets	54,406	51,596
Property and equipment, net	8,452	7,897
Intangible assets	36,610	37,297
Goodwill	26,600	25,790
Other non-current assets	66	1,583
Total assets	$ 126,134	$ 124,163
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,933	$ 8,236
Accrued liabilities	8,864	10,470
Deferred revenue	2,170	2,087
Total current liabilities	18,967	20,793
Deferred income taxes	3,236	2,344
Other non-current liabilities	1,051	
Total liabilities	23,254	23,137
Stockholders equity:		
Common Stock, $0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 21,520,373 and 21,391,091	134,577	133,071
Accumulated deficit	(31,075)	(31,677)
Accumulated other comprehensive income (loss)	(622)	(368)
Total stockholders equity	102,880	101,026

Total liabilities and stockholders equity	$ 126,134	$ 124,163

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 March 31, 2007	2006
Revenue	$ 27,050	$ 19,383
Cost of revenue	10,175	7,294
Gross profit	16,875	12,089
Operating expenses:		
Marketing and selling	6,496	5,161
Research and development	3,824	2,490
General and administrative	4,108	2,155
Acquired in-process research and development		5,900
Total operating expenses	14,428	15,706
Income (loss) from operations	2,447	(3,617)
Other income (expense), net	241	(113)
Income (loss) before provision for income tax	2,688	(3,730)
Provision for income tax	1,169	949
Net income (loss)	$ 1,519	$ (4,679)
Earnings (loss) per share:		
Basic	$ 0.07	$ (0.25)
Diluted	$ 0.07	$ (0.25)
Weighted average shares used in the calculation of net income (loss) per share		
Basic	21,466	18,485
Diluted	22,734	18,485

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

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NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating activities:		
Net income (loss)	$ 1,519	$ (4,679)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Acquired in-process research and development		5,900
Depreciation and amortization	1,168	1,003
Accounts receivable reserves	25	28
Inventory reserves	207	96
Warranty reserves	56	226
Share-based compensation	375	357
Excess tax benefits on the exercise of options	(611)	(670)
Changes in operating assets and liabilities:		
Accounts receivable	632	(270)
Inventories	(1,884)	(1,833)
Prepaid expenses and other current assets	1,119	371
Accounts payable	(303)	1,455
Accrued liabilities and deferred revenue	(751)	(3,049)
Net cash provided by (used in) operating activities	1,552	(1,065)
Investing activities:		
Acquisition of property and equipment	(1,037)	(661)
Acquisition of business, net of cash acquired		(51,580)
Deposits and other assets		523
Sales of short-term investments		12,165
Net cash used in investing activities	(1,037)	(39,553)
Financing activities:		
Proceeds from stock option exercises and ESPP	520	680
Excess tax benefits upon the exercise of options	611	670
Borrowing on credit facility		10,000
Payments on borrowings		(625)
Net cash provided by financing activities	1,131	10,725
Exchange rate effect on cash and cash equivalents	(254)	(153)
Net increase (decrease) in cash and cash equivalents	1,392	(30,046)
Cash and cash equivalents, beginning of period	15,392	40,046
Cash and cash equivalents, end of period	$ 16,784	$ 10,000

Supplemental disclosure of cash flow information:				
Cash paid for interest	$		$	165
Cash paid for income taxes	$	621	$	342

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

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NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1- Basis of Presentation

The accompanying interim condensed consolidated financial statements of Natus Medical Incorporated (Natus, we, us, or the Company) have been prepared in accordance with accounting principles generally accepted in the United Sates of America (GAAP). Except as updated below, the accounting policies followed in the preparation of the interim condensed consolidated financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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 months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. A reclassifications has been made to the prior period condensed consolidated statement of cash flows to properly reflect the impact on cash flows from operating activities and financing activities of excess tax benefits on the exercise of options.

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries; intercompany transactions have been eliminated in consolidation.

Comprehensive Income

The following are the components of comprehensive income (loss) (in thousands):

	Three Months Ended March 31,	
	2007	2006
Net income (loss)	$ 1,519	$ (4,679)
Unrealized gain on available-for-sale securities		2
Foreign currency translation adjustment	(254)	(153)
Comprehensive income (loss)	$ 1,265	$ (4,830)

Stockholders Equity

The following are the changes in stockholders equity (in thousands):

	Three Months Ended March 31,	
	2007	2006
Beginning balance	$ 101,026	$ 68,965
Net income (loss)	1,519	(4,679)
Proceeds from stock option exercises and ESPP	520	680
Share-based compensation expense	375	357
Excess tax benefits on the exercise of options	611	670
Adoption of FIN No. 48	(917)	
Comprehensive income (loss)	(254)	(151)

Ending balance	$ 102,880	$ 65,842

New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs.

If the fair value option is elected for an instrument, SFAS 159 specifies that unrealized gains and losses for that instrument shall be reported in earnings at each subsequent reporting date. SFAS 159 is effective January 1, 2008. We have not determined whether we will adopt the provisions of SFAS 159 nor have we determined the impact on our consolidated financial statements if we were to adopt SFAS 159.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. We believe it is unlikely that SFAS 157 will have an impact on our consolidated financial statements because we do not deal in transactions requiring complex fair value measurements.

Recently Adopted Standards

In June 2006, the FASB issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. FIN No. 48, establishes a single model to address accounting for uncertain tax positions. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN No. 48 on January 1, 2007. For additional information about the adoption of FIN No. 48, refer to Note 9 *Income Taxes*.

In March 2006, FASB Emerging Issues Task Force (EITF) issued EITF 06-03, *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes. The guidance is effective for periods beginning after December 15, 2006. The Company presents sales net of sales taxes, and as such, EITF 06-03 had no impact on our method for recording sales taxes in the consolidated financial statements.

2- Business Combinations

Olympic The Company acquired privately held Olympic Medical Corp. in October 2006, for $16.9 million cash, including direct costs of the acquisition. In addition the Company assumed and immediately paid $2.7 million of Olympic Medical obligations associated with the acquisition. Olympic Medical, based in Seattle, Washington, develops and markets medical products used in the neonatal intensive care unit and pediatric department of the hospital, including devices for the detection of neurological function of newborns. The Company is obligated to make future payments pursuant to earnout provisions of the purchase agreement of up to $3.1 million over a three-year period based primarily on the achievement of certain revenue targets for the Olympic Cool-Cap System. During the three months ended March 31, 2007, the Company recorded $120,000 of additional purchase consideration pursuant to the earnout provision that was recorded as an increase to goodwill.

During the three months ended March 31, 2007, the Company made a $100,000 adjustment to the preliminary purchase price allocation to recognize accrued expenses that were not properly valued as of the purchase date. The adjustment resulted in an offsetting increase in goodwill.

Deltamed The Company purchased all the common stock of privately held Deltamed S.A. headquartered in Paris, France, and its wholly owned subsidiaries, Raciar-Alvar, located in Bordeaux, France, and IT-Med, located near Frankfurt, Germany (collectively Deltamed) in September 2006 for approximately $4.1 million cash including direct costs of the acquisition. Deltamed is a European manufacturer of medical devices used in the detection of neurological dysfunction, epilepsy, and sleep disorders through the use of electroencephalograph (EEG) and polysomnography (PSG) technologies. The acquisition adds to the Company s international growth opportunities by broadening its product offerings and leveraging its distribution organization.

Valuing certain components of the Olympic and Deltamed acquisitions, including primarily inventory valuation, deferred taxes, and accrued expenses, required the Company to make estimates that may be adjusted in the future; consequently the purchase price allocations are considered preliminary. Final determination of these estimates as of the purchase dates could result in adjustments to the preliminary purchase price allocations, with offsetting adjustments to Goodwill.

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Nascor The Company completed the purchase of certain product rights, manufacturing and distribution contracts, inventory, and intangible assets from Nascor Pty. Ltd. (the Nascor assets) in September 2006 for $953,000 cash including direct costs of the acquisition. In addition, the Company is obligated to make future payments pursuant to earnout provisions of the purchase agreement of up to $675,000 over a three-year period based primarily on the achievement of certain revenue targets. The Company previously distributed certain Nascor products in the United States and certain other countries. This acquisition provides the Company with worldwide distribution rights and is expected to improve its margins.

Bio-logic The Company acquired Bio-logic Systems Corp. (Bio-logic) in January 2006 for $69.3 million cash including direct costs of the acquisition. The Company made this acquisition to supplement its hearing screening business with the addition of Bio-logic s diagnostic hearing products as well as to open up new market opportunities in the areas of EEG diagnosis and monitoring of neurological dysfunction and sleep disorders.

During the three months ended March 31, 2007, the Company recorded an increase to goodwill of $503,000 associated with a reduction in deferred tax assets as of the acquisition date related to the Company s research and development tax credit carryforwards, as more fully described in Note 9 *Income Taxes*.

Fischer-Zoth The Company purchased all the common stock of privately held Fischer-Zoth Diagnosesysteme GmbH and affiliated entities (Fischer-Zoth), as well as intangible assets held individually by the owners of Fischer-Zoth in September 2004 for $5.7 million cash including direct costs of the acquisition. Fischer-Zoth is a manufacturer of otoacoustic emissions (OAE) products used to detect hearing impairment in newborns through adults. The acquisition added to the Company s growth opportunities by broadening its product offerings in hearing screening and supporting expansion into new markets. The Company is obligated to make future payments pursuant to earnout provisions of the purchase agreement over a three-year period based primarily on the purchased entities achieving certain performance objectives.

Amortization of Intangible Assets Acquired Through Business Combinations

Amortization of intangible assets associated with the Company s business combinations for the three months ended March 31, 2007 and 2006 was $687,000 and $566,000, respectively.

3- Basic and Diluted Net Income (Loss) Per Common Share

Net income (loss) per share is computed in accordance with SFAS No. 128, *Earnings per Share.* Basic net income (loss) per share is based upon the weighted average number of common shares outstanding during the period. Diluted net income (loss) 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 the Company s stock awards plans and are calculated under the treasury stock method. Common equivalent shares from unexercised stock options and 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 options is greater than the average market price of the stock for the period.

For the three months ended March 31, 2007, common stock equivalents of 1,268,289 shares were included in the weighted average shares outstanding used to calculate diluted income per share. For the three months ended March 31, 2007, common stock equivalents of 31,750 shares were excluded from the calculation of diluted income per share because the exercise price of such options was greater than the average market price of the stock for the period.

4- Inventories

Inventories consisted of (in thousands):

	March 31, 2007	December 31, 2006
Raw materials and subassemblies	$	