NUVASIVE INC
Form 10-Q
April 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016

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: 000-50744

NUVASIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware	33-0768598
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7475 Lusk Boulevard

San Diego, CA 92121

(Address of principal executive offices)

(858) 909-1800

(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 such shorter period than the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

Large accelerated filer x	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 x

As of April 21, 2016 there were 49,833,030 shares of the registrant's common stock (par value $0.001 per share) outstanding.

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NuVasive, Inc.

Quarterly Report on Form 10-Q

March 31, 2016

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NUVASIVE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except par values and share amounts)

	March 31, 2016	December 31, 2015
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	$ 270,105	$ 192,339
Short-term marketable securities	42,495	165,423
Accounts receivable, net of allowances of $5,856 and $5,320, respectively	126,088	127,595
Inventory, net	200,711	168,140
Prepaid income taxes	44,921	40,540
Prepaid expenses and other current assets	7,844	8,790
Total current assets	692,164	702,827
Property and equipment, net	152,988	141,441
Long-term marketable securities	18,381	112,332
Intangible assets, net	266,089	85,076
Goodwill	404,307	154,281
Deferred tax assets	8,176	67,051
Restricted cash and investments	7,316	5,615
Other assets	19,698	17,404
Total assets	$ 1,569,119	$ 1,286,027
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 77,357	$ 60,986
Accrued payroll and related expenses	30,276	37,641
Contingent liabilities	19,497	—
Income tax liabilities	930	990
Total current liabilities	128,060	99,617
Senior convertible notes	669,398	372,920
Deferred and income tax liabilities, non-current	11,496	8,602
Non-current litigation liabilities	88,310	88,261
Other long-term liabilities	20,170	14,425
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value; 120,000,000 shares authorized at March 31, 2016 and December 31, 2015, 53,418,900 and 52,616,471 issued and outstanding at March 31, 2016	53	53

and December 31, 2015, respectively		
Additional paid-in capital	961,206	989,387
Accumulated other comprehensive loss	(9,079)	(12,112)
Accumulated deficit	(129,533)	(120,647)
Treasury stock at cost; 3,647,690 shares and 3,316,794 shares at March 31, 2016 and December 31, 2015, respectively	(177,814)	(161,788)
Total NuVasive, Inc. stockholders' equity	644,833	694,893
Non-controlling interests	6,852	7,309
Total equity	$ 651,685	$ 702,202
Total liabilities and equity	$ 1,569,119	$ 1,286,027

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended March 31,	
(unaudited)	2016	2015
Revenue	$215,104	$192,383
Cost of goods sold (excluding below amortization of intangible assets)	54,226	45,664
Gross profit	160,878	146,719
Operating expenses:		
Sales, marketing and administrative	130,195	116,096
Research and development	10,629	9,264
Amortization of intangible assets	7,871	2,996
Litigation liability (gain)	—	(42,575)
Business transition costs	(50)	5,373
Total operating expenses	148,645	91,154
Interest and other expense, net:		
Interest income	328	419
Interest expense	(8,472)	(7,126)
Loss on repurchases of convertible notes	(17,444)	—
Other income, net	50	424
Total interest and other expense, net	(25,538)	(6,283)
(Loss) income before income taxes	(13,305)	49,282
Income tax benefit (expense)	3,962	(17,885)
Consolidated net (loss) income	$(9,343)	$31,397
Add back net loss attributable to non-controlling interests	$(457)	$(163)
Net (loss) income attributable to NuVasive, Inc.	$(8,886)	$31,560
Net (loss) income per share attributable to NuVasive, Inc.:		
Basic	$(0.18)	$0.66
Diluted	$(0.18)	$0.61
Weighted average shares outstanding:		
Basic	49,617	47,989
Diluted	49,617	51,716

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Three Months Ended March 31,	
(unaudited)	2016	2015
Consolidated net (loss) income	$(9,343)	$31,397
Other comprehensive income (loss):		
Unrealized gain on marketable securities, net of tax	348	133
Translation adjustments, net of tax	2,685	(2,185)
Other comprehensive income (loss)	3,033	(2,052)
Total consolidated comprehensive (loss) income	(6,310)	29,345
Net loss attributable to non-controlling interests	457	163
Comprehensive (loss) income attributable to NuVasive, Inc.	$(5,853)	$29,508

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)	Three Months Ended March 31, 2016			2015		
Operating activities:						
Consolidated net (loss) income	$	(9,343	)	$	31,397	
Adjustments to reconcile net (loss) income to net cash provided by operating activities:						
Depreciation and amortization		21,224			16,051	
Loss on repurchases of convertible notes		17,444			—	
Amortization of non-cash interest		5,112			4,331	
Stock-based compensation		4,492			7,611	
Reserves on current assets		4,162			633	
Other non-cash adjustments		3,491			6,172	
Deferred income taxes		1,794			11,015	
Changes in operating assets and liabilities, net of effects from acquisitions:						
Accounts receivable		6,939			5,931	
Inventory		(9,449	)		(11,367	)
Prepaid expenses and other current assets		1,303			444	
Accounts payable and accrued liabilities		10,040			17,428	
Accrued royalties		(19	)		(47,459	)
Accrued payroll and related expenses		(9,219	)		(10,163	)
Litigation liability		—			7,730	
Income taxes		9,421			(13,731	)
		57,392			26,023	

Net cash provided by operating activities		
Investing activities:		
Acquisition of Ellipse Technologies, net of cash acquired	(380,674)	—
Other acquisitions and investments	(8,079)	(1,357)
Purchases of intangible assets	(1,027)	(27,389)
Purchases of property and equipment	(18,279)	(30,694)
Purchases of marketable securities	(36,096)	(71,129)
Proceeds from sales of marketable securities	253,435	105,794
Purchases of restricted investments	—	(32,616)
Net cash used in investing activities	(190,720)	(57,391)
Financing activities:		
Incremental tax benefits related to stock-based compensation awards	—	8,092
Proceeds from the issuance of common stock	444	1,403
Payment of contingent consideration	—	(514)
Purchase of treasury stock	(12,599)	(30,944)
Proceeds from issuance of convertible debt, net of issuance costs	634,140	—
Proceeds from sale of warrants	44,850	—
Purchase of convertible note hedge	(111,150)	—
Repurchases of convertible notes	(343,835)	—
Proceeds from revolving line of credit	50,000	—
Repayments on revolving line of credit	(50,000)	—
Other financing activities	(1,442)	(45)
Net cash provided by (used in) financing activities	210,408	(22,008)

Effect of exchange rate changes on cash		686		(517)
Increase (decrease) in cash and cash equivalents		77,766		(53,893)
Cash and cash equivalents at beginning of period		192,339		142,387
Cash and cash equivalents at end of period	$	270,105	$	88,494

See accompanying Notes to Unaudited Consolidated Financial Statements.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Description of Business

NuVasive, Inc. (the "Company" or "NuVasive") was incorporated in Delaware on July 21, 1997, and began commercializing its products in 2001. The Company's principal product offering includes a minimally-disruptive surgical platform called Maximum Access Surgery, or MAS. The MAS platform combines three categories of solutions that collectively minimize soft tissue disruption during spine fusion surgery, provide maximum visualization and are designed to enable safe and reproducible outcomes for the surgeon and the patient. The platform includes our proprietary software-driven nerve detection and avoidance systems, NVM5, and Intraoperative Monitoring ("IOM"), services and support; MaXcess, an integrated split-blade retractor system; and a wide variety of specialized implants and biologics. The Company also recently launched Integrated Global Alignment ("iGA"), in which products and computer assisted technology under the MAS platform help achieve more precise spinal alignment. The individual components of the MAS platform, and many of the Company's products, can also be used in open or traditional spine surgery. The Company continues to focus research and development efforts to expand its MAS product platform and advance the applications of its unique technology into procedurally-integrated surgical solutions. The Company dedicates significant resources toward training spine surgeons on its unique technology and products.

The Company's primary business model is to loan its MAS systems to surgeons and hospitals that purchase implants, biologics and disposables for use in individual procedures. In addition, for larger customers, the Company's proprietary nerve monitoring systems, MaXcess and surgical instrument sets are placed with hospitals for an extended period at no up-front cost to them. The Company also offers a range of bone allograft in patented saline packaging, disposables and spine implants, which include its branded CoRoent® products and fixation devices such as rods, plates and screws. The Company sells MAS instrument sets, MaXcess and nerve monitoring systems to hospitals, however, such sales are immaterial to the Company's results of operations.

On February 11, 2016 the Company acquired Ellipse Technologies, Inc. ("Ellipse Technologies"), which now operates as a wholly owned subsidiary under the renamed legal entity NuVasive Specialized Orthopedics, Inc. ("NSO"). NSO designs and sells expandable growing rod implant systems that can be non-invasively lengthened following implantation with precise, incremental adjustments via an external remote controller using magnetic technology called MAGnetic External Control, or MAGEC. The technology platform provides the basis of NSO's core product offerings, including MAGEC-EOS, which allows for the minimally invasive treatment of early-onset and adolescent scoliosis, as well as PRECICE limb lengthening system, which allows for the correction of long bone limb length discrepancy, as well as enhanced bone healing in patients that have experienced traumatic injury.

The Company intends to continue development on a wide variety of projects intended to broaden surgical applications for greater procedural integration of its MAS techniques and additional applications of the MAGEC technology. Such applications include tumor, trauma, and deformity, as well as increased fixation options and sagittal alignment products. The Company also expects to continue expanding its other product and services offerings as it executes on its strategy to offer customers an end-to-end, integrated procedural solution for spine surgery that distinguishes the Company from traditional spine implant companies.

Basis of Presentation and Principles of Consolidation

The accompanying Unaudited Consolidated Financial Statements include the accounts of the Company and its majority-owned or controlled subsidiaries, collectively referred to as either NuVasive or the Company. The Company translates the financial statements of its foreign subsidiaries using end-of-period exchange rates for assets and liabilities and average exchange rates during each reporting period for results of operations. When there is a portion of equity in an acquired subsidiary not attributable, directly or indirectly, to the respective parent entity, the Company records the fair value of the non-controlling interests at the acquisition date and classifies the amounts attributable to non-controlling interests separately in equity in the Company's consolidated financial statements. Any subsequent changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary are accounted for as equity transactions. All significant intercompany balances and transactions have been eliminated in consolidation.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The accompanying Unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). Operating results for the three months ended March 31, 2016 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. These Unaudited Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2015 included in the Company's Annual Report on Form 10-K filed with the SEC. In the opinion of management, the Unaudited Consolidated Financial Statements include all adjustments that are of a normal and recurring nature that are necessary for the fair presentation of the Company's financial position and of the results of operations and cash flows for the periods presented.

The Company has reclassified historically presented product offerings revenue to conform to the current year presentation. The reclassification had no impact on previously reported results of operations or financial position.

Change in Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Accounting Pronouncements Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), an updated standard on revenue recognition. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported by companies while also improving comparability in the financial statements of companies reporting using International Financial Reporting Standards or GAAP. The main purpose of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively and improve guidance for multiple-element arrangements. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. Accordingly, the updated standard is effective for the Company in the first quarter of fiscal 2018. The Company is evaluating the impact of implementation and transition approach of this standard on its financial statements but does not anticipate a material impact on its financial statements.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which requires that (i) all equity investments, other than equity-method investments, in unconsolidated entities generally be measured at fair value through earnings and (ii) when the fair value option has been elected for financial liabilities, changes in fair value due to instrument-specific credit risk will be recognized separately in other comprehensive income. Additionally, the ASU 2016-01 changes the disclosure requirements for financial instruments. The new standard will be effective for the Company starting in the first quarter of fiscal 2019. Early adoption is permitted for certain provisions. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt certain provisions early.

In February 2016, the FASB issued new guidance related to leases that outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new guidance requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company starting in the first quarter of fiscal 2019. Early adoption is permitted. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In March 2016, the FASB issued Accounting Standards Update 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), which amends ASC Topic 718, Compensation – Stock Compensation. ASU 2016-09 includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. ASU 2016-09 is effective for public entities for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. Early adoption is permitted in any interim or annual period, with any adjustments reflected as of the beginning of the fiscal year of adoption. The Company is evaluating the impact of this standard on its financial statements.

Recently Adopted Accounting Standards

In April 2014, the FASB issued ASU No. 2015-03 amended requirements that require debt issuance costs, related to a recognized debt liability, to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, effective for the Company beginning January 1, 2016 applied retroactively for all consolidated balance sheets presented. The Company applied the amended presentation requirements in the first quarter 2016, which does not have a material impact on its financial statements. This change resulted in a reclassification from other assets to senior convertible notes on the Consolidated Balance Sheets presented. See Note 6 to the Unaudited Consolidated Financial Statements for revised presentation.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) includes unrealized gains or losses on the Company's marketable securities and foreign currency translation adjustments. The cumulative translation adjustments included in accumulated other comprehensive income (loss) were a net cumulative loss of $9.1 million and $11.6 million at March 31, 2016 and December 31, 2015, respectively.

Business Transition Costs

The Company incurs costs related to integration and business transition activities which include severance, relocation, consulting, and other costs directly associated to such activities. During the three months ended March 31, 2016, the business transition costs were immaterial to the results of operations. During the three months ended March 31, 2015, the Company incurred $5.4 million of such costs, which included a $3.4 million charge associated with the resignation of the Company's former Chief Executive Officer and Chairman of the Board, which occurred in the first quarter 2015. The $3.4 million charge includes certain severance and compensation-related charges, net of certain forfeitures of previously recognized equity-based compensation.