

NATUS MEDICAL INC  
Form 10-K  
March 14, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2010**

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 33001

**NATUS MEDICAL INCORPORATED**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of

**77 0154833**  
(I.R.S. Employer

incorporation or organization)

Identification Number)

**1501 Industrial Road, San Carlos, California 94070**

(Address of principal executive offices, including zip code)

**(650) 802 0400**

(Registrant's telephone number, including area code)

# Edgar Filing: NATUS MEDICAL INC - Form 10-K

## Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.001 par value per share	The NASDAQ Stock Market LLC  (Nasdaq Global Select Market)

## Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K.

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

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of June 30, 2010, the last business day of Registrant's most recently completed second fiscal quarter, there were 28,658,910 shares of Registrant's common stock outstanding, and the aggregate market value of such shares held by non-affiliates of Registrant (based upon the closing sale price of such shares on the Nasdaq Global Select Market on June 30, 2010) was \$385,015,698. Shares of Registrant's common stock held by each executive officer and director and by each entity that owns 5% or more of Registrant's outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On March 7, 2011, the registrant had 28,974,250 shares of its common stock outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

The Registrant has incorporated by reference, into Part III of this Form 10-K, portions of its Proxy Statement for the 2011 Annual Meeting of Stockholders.

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**ANNUAL REPORT ON FORM 10-K**

**TABLE OF CONTENTS**

<b><u>PART I</u></b>		1
ITEM 1.	<u>Business</u>	1
ITEM 1A.	<u>Risk Factors</u>	20
ITEM 1B.	<u>Unresolved Staff Comments</u>	31
ITEM 2.	<u>Properties</u>	31
ITEM 3.	<u>Legal Proceedings</u>	32
ITEM 4.	<u>(Reserved)</u>	32
<b><u>PART II</u></b>		33
ITEM 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	33
ITEM 6.	<u>Selected Financial Data</u>	34
ITEM 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	36
ITEM 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
ITEM 8.	<u>Financial Statements and Supplementary Data</u>	49
ITEM 9A.	<u>Controls and Procedures</u>	51
<b><u>PART III</u></b>		54
ITEM 10.	<u>Directors, Executive Officers and Corporate Governance</u>	54
ITEM 11.	<u>Executive Compensation</u>	54
ITEM 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	54
ITEM 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	55
ITEM 14.	<u>Principal Accountant Fees and Services</u>	55
<b><u>PART IV</u></b>		56
ITEM 15.	<u>Exhibits and Financial Statement Schedule</u>	56
<b><u>SIGNATURES</u></b>		60

**Table of Contents****PART 1****ITEM 1. Business**

*This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 about Natus Medical Incorporated ( Natus, we, us, or our Company ). These statements include, among other things, statements concerning our expectations, beliefs, plans, intentions, future operations, financial condition and prospects, and business strategies. The words may, will, continue, estimate, project, intend, believe, expect, anticipate, and other similar expressions generally identify forward-looking statements. Forward-looking statements in this Item 1 include, but are not limited to, statements regarding the effectiveness and advantages of our products, factors relating to demand for and economic advantages of our products, our plan to develop and acquire additional technologies, products or businesses, our marketing, technology enhancement, and product development strategies.*

*Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause the actual results to differ materially from those that we predicted in the forward-looking statements. Investors should carefully review the information contained under the caption Risk Factors contained in Item 1A for a description of risks and uncertainties that could cause actual results to differ from those that we predicted. All forward-looking statements are based on information available to us on the date hereof, and we assume no obligation to update forward-looking statements, except as required by Federal Securities laws.*

*Natus®, AABR®, ABAer®, ALGO®, AOAE®, AuDX®, Balance Manager®, Balance Master®, Biliband®, Bio-logic®, Ceegraph®, CHAMP®, Cochlea Scan®, Cool Cap®, Ear Couplers®, Echo Screen®, EquiTest®, Fischer-Zoth®, Flexicoupler®, Gumdrop®, Keypoint®, Keypoint AU®, Keypoint EU®, Keypoint JP®, MASTER®, Medix®, Medix I.C.S.A.®, Navigator®, Neatnick®, neoBLUE®, Neuromax®, NeuroWorks®, Oxydome®, Servocuna®, Sleeprite®, Sleepscan®, Smart Scale®, Tootsweet®, Traveler®, Warmette® and VAC PAC® are registered trademarks of Natus Medical Incorporated and its subsidiaries. Accuscreen®, Bili-Lite Pad®, Bili-Lite®, Biomark®, Circumstraint®, Coherence®, Deltamed®, inVision®, MiniMuffs®, Neometrics® and Smartpack® are non-registered trademarks of Natus and its subsidiaries. Solutions for Newborn C@ris® a non-registered service mark of Natus.*

**Overview**

Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, incubators to control the newborn's environment, and software systems for managing and tracking disorders and diseases for public health laboratories.

We have completed a number of acquisitions since 2003, consisting of either the purchase of a company, substantially all of the assets of a company, or individual products or product lines. Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008, Hawaii Medical and Alpine Biomed in 2009, and Medix in 2010.

**Product Families**

We categorize our products into the following product families:

**Hearing** Includes products for newborn hearing screening and diagnostic hearing assessment.

**Table of Contents**

***Neurology*** Includes products for diagnostic electroencephalography (EEG), electromyography (EMG), intra-operative monitoring (IOM), diagnostic sleep analysis, or polysomnography (PSG), newborn brain monitoring, and assessment of balance and mobility disorders.

***Newborn Care*** Includes thermoregulation devices and products for the treatment of brain injury and jaundice in newborns. Our principal product offerings within these product families are presented in the table on the following page.

## **Table of Contents**

### ***Our Product Offerings***

#### **Hearing**

##### ***Newborn Hearing Screening***

###### *Overview*

Hearing impairment is the most common treatable chronic disorder in newborns, affecting as many as five babies out of every 1,000 newborns. It is estimated that 20,000 hearing-impaired babies are born in the United States ( U.S. ) every year, and as many as 60,000 more in the rest of the developed world. Until the introduction of universal newborn hearing screening programs, screening was generally performed only on those newborns that had identifiable risk factors for hearing impairment. However, screening only those newborns with risk factors for hearing impairment overlooks approximately half of newborns with some level of hearing impairment.

Early identification of hearing impairment and early intervention has been shown to improve language development significantly. Undetected hearing impairment often results in the failure to learn, process spoken language, and speak. If hearing impairment is not detected prior to discharge from the hospital it is often not detected until the child is 18 months of age or older. A 1997 study conducted at the University of Colorado, Boulder evaluated the impact of hearing impairment on language and speech. All of the children evaluated in the study were born with a hearing impairment but differed by the age at which the hearing impairment was detected. The study concluded that those children whose hearing loss was detected early and who received appropriate treatment had significantly better language skills and vocabularies than those children whose hearing loss was detected later.

###### *Newborn Hearing Screening in the United States*

We estimate that today approximately 95% of the children born in the U.S. are being screened for hearing impairment prior to discharge from the hospital. In 1999, the American Academy of Pediatrics Task Force on Newborn and Infant Hearing first published specific guidelines for universal newborn hearing screening programs. In 2000 and 2007, the Joint Committee on Infant Hearing ( JCIH ) Position Statements outlined principles, guidelines, and benchmarks for early hearing detection and intervention programs. These principles and guidelines are considered the standard of care today. Because positive results are referred to an audiologist or an Ear, Nose and Throat physician ( ENT ) for additional testing and evaluation, limiting the number of refers stemming from false positive results reduces the cost of a newborn screening program. In addition, false positive results can cause unnecessary emotional distress for parents.

The 2007 JCIH Position Statement updated and expanded the definition of targeted hearing loss and recommended a specific protocol for babies admitted to the Neonatal Intensive Care Unit ( NICU ) for more than 5 days. Additionally, the document expressed increased awareness, not only of the need for diagnostic audiology evaluation for children diagnosed with hearing impairment at birth, but also for surveillance and hearing screening for children at risk of delayed onset and progressive hearing impairment during the first three years of life.

###### *Newborn Hearing Screening Techniques*

The two traditional technologies used to screen newborns and infants for hearing impairment are auditory brainstem response and otoacoustic emissions.

*Auditory brainstem response ( ABR ).* ABR technology is the most accurate and comprehensive method for screening and diagnosing hearing impairment. ABR technology is based on detecting the brain's electric impulses resulting from a specific auditory stimulus. ABR screening devices, used for newborn hearing screening, detect and analyze the brainwave response resulting from audible click stimuli presented to the

## **Table of Contents**

infant's ears. Automated Auditory Brainstem Response ( AABR ) devices were developed to automatically analyze the ABR waveform resulting from the auditory stimuli with computerized detection algorithms and statistical analysis. These devices can be used by any level of hospital personnel with a minimal amount of training and will deliver a clinically valid and accurate screen. The detection algorithms indicate a PASS or REFER result that requires no interpretation, thereby reducing staffing requirements, test times, and total hearing screening program costs. A REFER test result indicates that the patient should be referred to an Audiologist or ENT for further diagnostic evaluation.

*Otoacoustic emission ( OAE ).* OAEs are sounds created by the active biomechanical processes within the sensory cells of the cochlea. They occur both spontaneously and in response to acoustic stimuli. OAE screening uses a probe placed in the ear canal to deliver auditory stimuli and to measure the response of the sensory cells with a sensitive microphone. OAE screening devices have technology that allows them to discriminate between randomly occurring OAEs, OAEs created by interfering room noise present in the test environment, and the OAEs that are a response to specific test stimuli. Automated OAE screening devices are capable of filtering non-specific OAEs in order to detect and analyze the OAEs that lead to an accurate screen of the infant's hearing. While a PASS test result indicates a proper functioning cochlea, a REFER test result indicates that the OAEs are absent or small compared to normal data. A REFER test result indicates that the patient should be referred to an Audiologist or ENT for further diagnostic evaluation. OAE technology is unable to detect hearing disorders affecting the neural pathways, such as auditory neuropathy. Estimates of the incidence rate of auditory neuropathy among hearing impaired newborns vary widely, but are thought to be in the range of 5% to 15%.

### ***Newborn Hearing Screening Product Lines***

Our newborn hearing screening product lines consist of the ALGO, ABaer, AuDX, and Echo-Screen newborn hearing screeners. These hearing screening products utilize proprietary signal detection technologies to provide accurate and non-invasive hearing screening for newborns and are designed to detect hearing loss at 35 dB nHL or higher. Each of these devices is designed to generate a PASS or REFER result.

***ALGO 5 and 3i Newborn Hearing Screeners.*** These AABR devices deliver thousands of soft audible clicks to the newborn's ears through sound cables and disposable earphones connected to the instrument. Each click elicits an identifiable brain wave, which is detected by disposable electrodes placed on the head of the child and analyzed by the screening device. These devices use our proprietary AABR signal detection algorithm.

***ABaer Newborn Hearing Screener.*** The ABaer, which is a PC-based newborn hearing screening device, offers a combination of AABR, OAE, and diagnostic ABR technologies in one system. The automatic ABR technology utilizes our patented Point Optimized Variance Ratio ( POVR ) signal detection algorithm developed by the House Ear Institute. Like our ALGO newborn hearing screeners, this device delivers thousands of soft audible clicks to the newborn's ears through sound cables and disposable earphones. Each click elicits an identifiable brain wave, which is detected by disposable electrodes placed on the head of the child and analyzed by the screening device. The ABaer OAE software is the same technology used in our AuDX product and the diagnostic ABR software is the same technology used in our Navigator diagnostic hearing assessment product.

***AuDX and Echo-Screen.*** Our AuDX product is a hand-held OAE screening device that can be used for newborn hearing screening, as well as for patients of all ages, from children through adults. Our Echo-Screen product is a hand-held combination AABR and OAE device for newborn screening that can also be used for children through adults in OAE-only mode. These devices record and analyze OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient's ear canal. OAE technology is unable to detect hearing disorders affecting the neural pathways, such as auditory neuropathy.

## **Table of Contents**

### ***Hearing Screening Supply Products***

For infection control, accuracy, and ease of use, the supply products used with our newborn hearing screening devices are designed as single-use, disposable products. Each screening supply product is designed for a specific hearing screening technology.

***ABR Screening Supply Kits.*** Each ABR screen is carried out with single-use earphones and electrodes, which are alcohol and latex-free. The adhesives used in these supply products are specially formulated for use on the sensitive skin of newborns. To meet the needs of our customers we offer a variety of packaging options.

***OAE Supply Products.*** Each OAE screen is carried out with single-use ear tips that are supplied in a variety of sizes and packaging options.

### ***Diagnostic Hearing Assessment***

#### ***Overview***

We design and manufacture a variety of products used to screen for or diagnose hearing loss, or to identify abnormalities affecting the peripheral and central auditory nervous systems in patients of all ages. The technology used in most of these systems is either electrodiagnostic in nature or measures a response from the cochlea known as an OAE.

Electrodiagnostic systems record electrical activity generated in the central nervous system. An electrodiagnostic testing device delivers acoustic stimuli to the ears while electrodes placed on the scalp record the brain's electrical response. The most common auditory test performed with electrodiagnostic equipment is the ABR test. This test, which records brainwaves that correspond to responses from the inner ear and brainstem, is used to screen for and define hearing loss characteristics, particularly for patients who cannot reliably respond to standard behavioral tests of hearing, either verbally or through motor response. A technician with minimal training can operate an instrument that performs an automated ABR screening test. More advanced ABR testing techniques that either define the nature of the hearing loss or that screen for other auditory abnormalities such as an acoustic tumor, require the expertise of a trained clinician, usually an audiologist or an ENT physician, an understanding of the technology being used, and the ability to interpret complex waveforms that represent the brain's electrical activity.

In the follow up evaluation of newborns diagnosed with hearing impairment, the clinician can distinguish between hearing impairments caused by mechanical or sensory dysfunction of the ear versus auditory neuropathy. Recent studies confirm the importance of making this distinction, as appropriate treatments for these impairments differ. One study showed that for patients diagnosed with auditory neuropathy, approximately 15% reported some benefit from hearing aids for language learning, while improvement in speech comprehension and language acquisition was reported in 85% of patients who received cochlear implants.

#### ***Diagnostic Hearing Assessment Product Lines***

Our diagnostic hearing assessment products consist of the Navigator Pro system, the Scout Sport portable diagnostic device and the AuDX PRO.

***Navigator PRO.*** Our Navigator PRO for hearing assessment consists of a base system that is augmented by discrete software applications that are marketed as enhancements to the system. The Navigator Pro System is a PC-based, configurable device that utilizes evoked potentials, which are electrical signals recorded from the central nervous system that appear in response to repetitive stimuli, such as a clicking noise. The evoked potentials are used to record and display human physiological data associated with auditory and hearing-related disorders. The Navigator Pro System can be used for patients of all ages, from children to adults, including infants and geriatric patients. The device can be configured with additional proprietary software programs for various applications. These additional software programs include: CHAMP, MASTER, AEP, VEMP, ABaer, and Scout.



## **Table of Contents**

**Scout SPORT.** The Scout SPORT is a PC-based OAE system. The ultra-portable Scout Sport can be carried from one computer to another to test in different locations. For office-based environments, the Scout Sport can be used with a dedicated notebook computer to create an independent portable system.

**AuDX PRO.** The AuDX PRO is a hand-held OAE screening device with a large color display that can be used for patients of all ages. The AuDX PRO records and analyzes OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient's ear canal.

### ***Diagnostic Hearing Supply Products***

For infection control, accuracy, and ease of use, most supply products used with our diagnostic hearing devices and systems are designed as single-use, disposable products. Each screening supply product is designed for a specific diagnostic hearing technology, and is similar in nature to our previously described OAE supply products for use in newborn hearing screening.

### ***Neurology***

Our monitoring systems for neurology represent a comprehensive line of products that are used by physicians, nurses and medical technologists to assist in the diagnosis and monitoring of neurological disorders of the central and peripheral nervous system and as an aid in monitoring patients during surgery, while under sedation, or in post-operative care. Our product lines consist of the following:

***Electroencephalography or EEG*** Equipment that monitors and visually displays the electrical activity generated by nerve cells in the brain for both diagnosis and monitoring of neurological disorders in the hospital, laboratory, physician office or patient's home.

***Electromyography or EMG*** Equipment that measures electrical activity in nerves, muscles, and the spinal cord.

***Intra-operative Monitoring or IOM*** Products that assist surgeons in preserving the functional integrity of a patient's nervous system during and after complex surgical procedures.

***Polysomnography or PSG*** Equipment that measures a variety of respiratory and neurological functions to assist in the diagnosis and monitoring of sleep disorders, such as snoring and obstructive sleep apnea, a condition that causes a person to stop breathing intermittently during sleep.

***Balance and Mobility*** Systems to diagnose and assist in treating balance disorders in an evidence-based, multidisciplinary approach.

### ***Diagnostic EEG Monitoring***

#### ***Overview***

We design, manufacture, and market a full line of computerized instruments used to help diagnose the presence of seizure disorders and epilepsy, look for causes of confusion, evaluate head injuries, tumors, infections, degenerative diseases, and metabolic disturbances that affect the brain, and assist in surgical planning. This type of testing is also done to diagnose brain death in comatose patients. These systems and instruments work by detecting, amplifying, and recording the brain's electrical impulses (EEGs). Routine EEG recording is done by placing electrodes on a patient's scalp over various areas of the brain to record and detect patterns of activity and specific types of electrical events. EEG technologists perform the tests, and neurologists review and interpret the results.

Routine outpatient EEG testing is performed in both hospital neurology laboratories and physician offices, providing physicians with a clinical assessment of a patient's condition. For patients with seizures that do not respond to conventional therapeutic approaches, long-term inpatient testing of EEGs and behavior is used to determine if surgical solutions are appropriate.



---

## **Table of Contents**

### ***Diagnostic Electroencephalograph Monitoring Product Lines***

Our diagnostic electroencephalograph ( EEG ) monitoring product lines for neurology consist of devices operating with our proprietary software augmented by signal amplifiers. These products are typically used in concert, as part of an EEG system by the neurology department of a hospital to assist in the diagnosis of assorted neurological conditions.

***NeuroWorks; Coherence; Harmonie.*** Our computerized EEG Systems include a broad range of products, from software licenses and ambulatory monitoring systems to advanced laboratory systems with multiple capabilities for EEG, ICU monitoring, long-term epilepsy monitoring of up to 256 channels, and physician review stations with quantitative EEG analysis capabilities.

***Stellate/Gotman Spike and Seizure; GridView.*** Our proprietary Spike and Seizure detection algorithm detects, summarizes, and reports EEG events that save health care professionals time by increasing the speed and accuracy of interpretation. GridView is a tool that allows the clinician to correlate EEG patterns with electrode contacts on a 3D view of the patient brain using magnetic resonance (MR) or computed tomography (CT) images, thus enabling the visualization and annotation of the brain surface and internal structures involved in the diagnosis of epilepsy.

***Proprietary Signal Amplifiers.*** Our proprietary signal amplifiers function as the interface between the patient and the computer, and are also known as the headbox. The headbox connects electrodes attached to the patient's head to our EEG monitoring systems. Our proprietary headbox products are sold for a wide variety of applications under the following brand names: Bio-logic Netlink, Xltek Trex, EEG32, EMU128, EMU40, Brain Monitor, and Schwarzer epas. Recent innovations in electronics technology and advanced internet-protocol data transmission enable certain of our amplifiers to record and transmit up to 32 channels of digital data using Ethernet communication.

Several additional options are available to enhance our EEG products, including: a digital video option, which provides synchronized video recording of a patient's behavior while recording electrical activity from the brain; our patented SmartPack software option, which is an innovative data compression process that reduces the size of data files by as much as 60%, and our Universal Reader which is a physician's review station that permits fast and easy data analysis in a graphical format.

### ***Diagnostic Electromyography Monitoring***

#### ***Overview***

Electromyography ( EMG ) involves the measurement of electrical activity of muscles both at rest and during contraction. Measuring the electrical activity in muscles and nerves can help diagnose diseases that damage muscle tissue or nerves. An electromyogram is done to determine if there is any disease present that damages muscle tissue, nerves, or the junctions between nerve and muscle (neuromuscular junctions). An electromyogram can also be used to diagnose the cause of weakness, paralysis, and muscle twitching and is also used as a primary diagnosis for carpal tunnel syndrome, which is the most frequently encountered peripheral compressive neuropathy.

#### ***Diagnostic EMG Product Lines***

***Xltek NeuroMax.*** A dedicated EMG device focused entirely on signal quality and clinical efficiency. The device gathers neurophysiological data that is saved to a fully customizable report, allowing physicians to take care of patients with the most informed advice.

***Xltek XCalibur.*** An EMG system that uses advanced circuit design and digital signal processing to deliver clean signals, making the process of acquiring patient data reliable and quick. The system provides enhanced data acquisition, reporting, and review capabilities.

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

***Dantec Keypoint.*** The Dantec Keypoint EMG and EP family of products feature superior amplifiers, stimulators, and outstanding signal quality. The Keypoint is used for advanced neurodiagnostic

## **Table of Contents**

applications such as single fiber EMG, visual and auditory evoked potentials, and in routine nerve conduction studies. The Keypoint system is also available in a portable laptop configuration.

**Dantec Clavis.** The Dantec Clavis device is a hand-held EMG and current stimulation ( STIM ) device that provides muscle and nerve localization information to assist with botulinum toxin injections (i.e. Botox). In conjunction with the Bo-ject hypodermic needle and electrodes, it delivers a precise dose of the agent.

**Schwarzer Topas.** The Topas system offers a wide range of sophisticated EMG and evoked potential ( EP ) examination protocols, as well as an attractive and functional design. The Topas system can be configured as a two or four channel system, as trolley-based or portable version, depending on the needs of the hospital or private practice.

### ***Intra Operative Monitoring***

#### *Overview*

Intra-operative monitoring ( IOM ) is the use of electrophysiological methods such as EMG and EEG to monitor the functional integrity of neural structures (i.e. brain, nerves, spinal cord) during surgery. The most common applications are in neurosurgery such as spinal surgery, some brain surgeries, ENT procedures, and peripheral nerve surgery. IOM is used to localize neural structures and test the function of these structures for early detection of intra-operative injury, allowing for immediate corrective measures.

### ***Intra-operative Monitoring Products***

**Protector.** The Protector system is an IOM system that provides medical professionals with all information necessary to make immediate and critical surgical decisions. The system combines flexibility with multi-modality allowing full coverage of IOM techniques. The Protector is available in a 16 or 32 channel configuration.

### ***Diagnostic Polysomnography Monitoring***

#### *Overview*

Increasing public awareness of sleep disorders has made sleep medicine a rapidly growing specialty. Polysomnography ( PSG ), which involves the analysis of respiratory patterns, brain electrical activity and other physiological data, has proven critical for the diagnosis and treatment of sleep-related diseases such as apnea, insomnia, and narcolepsy. A sleep study entails whole-night recordings of brain electrical activity, muscle movement, airflow, respiratory effort, oxygen levels, electrical activity of the heart (ECG or EKG), and other parameters. These recordings typically result in over 1,000 pages of data that are reviewed, analyzed, and scored by a technician, and summarized in a report for the physician. We market configured laboratory systems, portable systems, and ambulatory recorders for home monitoring.

### **Diagnostic PSG Monitoring Product Lines**

Our diagnostic PSG monitoring products can be used individually or as part of a networked system for overnight sleep studies to assist in the diagnosis of sleep disorders. These products include software licenses, ambulatory monitoring systems, and laboratory systems that combine multiple capabilities, including EEG monitoring, physician review stations, and quantitative EEG analysis capabilities.

**SleepWorks; Coherence; Harmonie.** Our diagnostic PSG systems capture and store all data digitally and provide time-saving features and software for acquiring and analyzing the data. The systems enable users to specify rules and personal preferences to be used during analysis, summarizing the results graphically and incorporating them in detailed reports. Software packages include customized analysis, tools and interfaces with third party equipment.

---

## **Table of Contents**

***Proprietary Amplifiers.*** Our data acquisition systems incorporate recent developments in superior amplifiers for sleep analysis. Sold under the brand names Xltek Trex and Connex, Bio-logic Netlink, Schwarzer epas duo 44 and comlab PSG, our amplifiers are used in stand-alone clinics and hospital settings. In addition to exceptional signal quality, headboxes include various tools such as built-in oximeters, and controls to allow the user to start and stop a study or perform electrode impedance testing either at the patient's bedside or from the monitoring room.

We also market a broad line of disposable products and accessories for the PSG laboratory. The Airflow Pressure Transducer uses pressure changes as an indicator of patient airflow levels, as contrasted to other monitoring devices that use temperature to indicate these levels. This product detects shallow breathing in situations where temperature related transducers might remain substantially unchanged. This method has been documented in industry publications to produce the signature waveform used in identifying a respiratory disorder known as Upper Airway Resistance Syndrome.

### ***Balance and Mobility***

#### *Overview*

Balance disorders impact a large percentage of the population in all age ranges from children to adults. Common complaints include dizziness, vertigo, or an inability to walk or drive a vehicle, which can all lead to the curtailment of daily life activities. These symptoms are exacerbated in elderly patients and can result in falls, orthopedic injuries, and sometimes death.

Balance problems are difficult to diagnose and treat because they can be caused by a combination of diseases or movement dysfunctions. Healthcare professionals who take a traditional clinical approach to the examination and treatment of balance problems typically explore one component of the balance system at a time. This approach often requires patients to consult multiple specialists, leading to patient dissatisfaction and increased health care costs, frequently without achieving an optimal outcome.

We believe the most effective strategy for diagnosing and treating balance disorders is an evidence-based, multidisciplinary approach applying a broad range of patient information. Our Balance Manager systems are designed to facilitate the assessment and management of complex balance problems in the context of the total patient to support this process. These systems are used in a broad spectrum of medical disciplines including otolaryngology, neurology, psychiatry, orthopedics/sports medicine, geriatrics, and physical rehabilitation.

#### ***Balance and Mobility Products***

Our principal balance and mobility products are sold under the Neurocom brand:

***EquiTest.*** Proprietary protocols in the EquiTest family of devices objectively quantify and differentiate among sensory, motor, and central adaptive impairments to balance control. This approach is commonly referred to as computerized dynamic posturography (CDP). CDP is complementary to clinical tests designed to localize and categorize pathological mechanisms of balance disorders in that it can identify and differentiate the functional impairments associated with the identified disorders.

***Balance Master.*** A family of devices providing objective assessment and retraining of the sensory and voluntary motor control of balance. With visual biofeedback on either a stable or dynamic support surface and in a stable or dynamic visual environment, the clinician can both assess and retrain patients performing tasks ranging from essential daily living activities through high-level athletic skills. The objective data captured by the device supports the design of effective treatment and/or training programs focused on the specific sensory and motor components underlying a patient's functional limitations.

## **Table of Contents**

***inVision.*** Our inVision device incorporates a set of proprietary diagnostic tests that quantify a patient's ability to maintain visual acuity and stable gaze while actively moving the head. The objective information enables the clinician to assess the patient's ability to live and move safely in a dynamic world and to participate in daily-life functions such as driving, walking through a grocery store, or actively engaging in family activities.

### **Newborn Care**

#### ***Newborn Care Products***

We manufacture a wide variety of products used in the medical care of newborns. These product lines include products to diagnose and treat newborn brain injury, as well as phototherapy lights to treat newborn jaundice. We also sell a variety of newborn care products to meet the needs of clinicians in the nursery and NICU. With our recent acquisition of Medix, we now offer a full range of thermoregulation devices use for the care of newborns.

#### ***Newborn Brain Injury***

##### ***Overview***

For many years, newborn infants admitted to the NICU of a hospital have routinely been monitored for heart activity, temperature, respiration, oxygen saturation, and blood pressure. Only recently has it also been considered important to monitor brain activity using continuous EEG. A cerebral function monitor, utilizing amplitude-integrated EEGs ( aEEGs ), is a device for monitoring background neurological activity.

##### ***Neurological Assessment and Treatment Options***

Early diagnosis of brain injury in newborns, when combined with early intervention, has been shown to reduce the severity of these brain injuries and in some cases, save the patient's life. These brain injuries, which can occur in as many as three out of every 1,000 newborns, are caused by conditions such as hypoxic ischemic encephalopathy ( HIE ), subclinical seizures, or neurological disorders. Diagnosing these conditions shortly after birth is imperative, as patients who undergo therapy within six hours after birth show a greater potential for improved outcomes. We believe that diagnoses utilizing aEEG technology can have a marked and positive impact upon the outcomes of some newborns suffering from brain injury.

#### ***Newborn Brain Injury Diagnostic Products***

Our newborn brain injury diagnostic products record and display parameters that the neonatologist uses to diagnose neurological disorders or brain injury in the newborn. These devices continuously monitor and record brain activity, aiding in the detection and treatment of HIE and seizures. The devices also monitor the effects of drugs and other therapies on brain activity and improve the accuracy of newborn neurological assessments. They are used with electrodes attached to the head of the newborn to acquire an EEG signal that is then filtered, compressed, and displayed graphically on the device or as a hardcopy printout. The monitors have touch screens for easy navigation and onscreen keyboards for data entry at the bedside.

***Olympic Brainz Monitor.*** The Olympic Brainz Monitor ( OBM ) is our latest generation Cerebral Function Monitor ( CFM ). The device can be used as a single channel, two-channel or three-channel device to continuously monitor and record brain activity. The OBM displays up to three channels of both aEEG and EEG data. Sophisticated networking, archiving and viewing functions facilitate consultation among medical professionals. Continuous impedance and corresponding EEG signals are also displayed, aiding better clinical management of the newborn.

***Brainz BRM3.*** The Brainz BRM3 is a bedside monitor that collects and measures electrical activity from both the right and left hemispheres of the brain. The monitor presents a simplified 2-channel EEG display, along with the option to view three channels of time-compressed amplified EEG s ( aEEG ), providing practitioners with the ability to monitor infants with a wider variety of neurological concerns

## **Table of Contents**

when compared to single-channel EEG. Outside the U.S. the BRM3 is sold with an optional spike and event detection algorithm called Recognize.

***Olympic CFM-6000.*** The Olympic CFM-6000 is a single-channel aEEG/EEG system that allows the neonatologist to diagnose neurological disorders or brain injury in the newborn. It helps determine the need for further neurological examination or transport to a tertiary-care center.

### ***Newborn Brain Injury Treatment***

***Olympic Cool-Cap System.*** The Olympic Cool-Cap is the only FDA-approved device for the treatment of moderate to moderately-severe HIE. A four-year clinical trial for the Cool-Cap was completed in 2003, and the FDA approved the product in December 2006. The clinical trial validated the benefit of selective head cooling as a means of reducing the temperature of the brain to diminish the severity of brain injury resulting from HIE in newborns. The device conforms to the clinical trial protocol and is designed to assist the clinician in safely administering treatment, thereby preventing or significantly reducing the severity of neurological injury associated with HIE. The Olympic Cool-Cap brain cooling system uses a single-patient, disposable, cooling cap to continuously circulate sterile water to the patient during the 72-hour treatment period.

### ***Thermoregulation Products***

#### *Overview*

Incubators offer a controlled, consistent microenvironment for thermoregulation and humidification within a closed system to maintain skin integrity and body temperature. This controlled microenvironment reduces noise and light, supporting developmental care while still providing access for clinical staff and family. Closed incubators are used for premature or sick babies who need a thermal and developmental environment to thrive and grow in the NICU. Transport incubators are designed to offer a controlled environment during transport either intra-hospital from one care area to another within a hospital building or inter-hospital between hospitals. Open infant warmers are the preferred device for labor and delivery rooms and NICU admission.

We currently offer the following thermoregulation products:

***Medix Incubators.*** Medix incubators provide high thermal performance with a double wall design. The Natal Care line of incubators includes easy to use control panels and features such as improved weighing functionality with automatic centering and an electronic tilting mechanism. The easy to clean, smooth design, and choice of options make these customizable incubators appropriate for different use environments.

***Medix Open Warmers.*** Medix open warmers include a full range of options including Apgar timers and resuscitation systems. Available with an attached bed or in free-standing configurations, the warmers feature a microprocessor controlled display module with easy to read display. The heater module has lateral movement capabilities to facilitate X-ray procedures while maintaining heat delivery.

***Medix Transport Incubators.*** Medix transport incubators are light in weight and easy to clean. They incorporate long lasting batteries and a choice of carts to meet the needs of different care environments.

### ***Jaundice Management***

#### *Overview*

The American Academy of Pediatrics estimates that each year 60% of the approximately four million newborns in the U.S. become jaundiced. According to the Journal of the American Medical Association, neonatal jaundice is the single largest cause for hospital readmission of newborns in the U.S., and accounts for 50% of readmissions. Because of the serious consequences of hyperbilirubinemia, the American



## Edgar Filing: NATUS MEDICAL INC - Form 10-K

Academy of Pediatrics recommends that all newborns be closely monitored for jaundice and has called for the physician to determine the presence or absence of an abnormal rate of hemolysis to establish the appropriate treatment for the newborn.

---

## **Table of Contents**

In 2004, the American Academy of Pediatrics issued new guidelines for the treatment of jaundice in newborns. The guidelines recommend phototherapy as the standard of care for the treatment of hyperbilirubinemia in infants born at 35 weeks or more of gestation. The guidelines further highlight the need for intense phototherapy, and specifically recommend the use of the blue light treatment incorporated into our neoBLUE products.

### ***Jaundice Management Products***

***neoBLUE Product Family.*** This product line consists of our neoBLUE, neoBLUE Mini, and neoBLUE Cozy devices, which utilize light emitting diodes ( LEDs ) to generate a high-intensity, narrow spectrum of blue light that is clinically proven to be most effective in the treatment of newborn jaundice. The neoBLUE phototherapy devices emit significantly less ultraviolet light and heat than conventional phototherapy devices, reducing the risk of skin damage and dehydration for infants undergoing treatment. Because of the high intensity of these lights, the treatment time associated with phototherapy is reduced.

***Bili-Lite Product Family.*** These devices utilize fluorescent light bulbs for the treatment of hyperbilirubinemia. The Bili-Bassinet provides intensive phototherapy from both under and over the baby for maximum surface area coverage. The Bili-Lite pad is a product designed for both hospital and home-based phototherapy.

***MediLED Product Family.*** This product line from Medix includes a full-size, free-standing LED phototherapy system and a MediLED mini light to be used on top of an incubator or attached to the Medix radiant warmer. The MediLED incorporates an array of blue and white LEDs, while the mini system utilizes blue super LEDs that provide high intensity phototherapy.

### ***Other Newborn Care Product Lines***

***Medical Devices.*** These products include devices such as: photometers, radiometers, patient warming lamps, neonatal heatshields, pediatric scales, blanket warming cabinets, exam lights, oxygen hoods, restraining boards, and our newborn circumstraint.

***Hawaii Medical Products.*** These single-use disposable products are sold into the NICU and nursery in hospitals. The Hawaii Medical line includes Gumdrops pacifiers, TootSweet sucrose solution, and NeatNick heel lancets, among a range of positioning devices, electrodes, and other newborn care products.

***Disposable Supplies.*** These products include other disposable supplies such as neonatal noise attenuators, phototherapy eye masks and x-ray shields for newborn gonads.

***Newborn Screening Data Management Product Line.*** Our suite of newborn screening data management products consists of proprietary software that collects, tracks, manages and reports newborn screening data to regional government health laboratories and national disease control centers. While all states have laws and/or regulations requiring newborn screening for metabolic disorders, the laws and regulations vary widely in the extent of screening required. Some states use tandem mass spectrometry in their newborn metabolic screening programs, which increases the number of treatable disorders that can be detected. Revenue from installation and upgrades of our newborn screening data management systems is classified as devices and systems revenue, and revenue from maintenance contracts on the systems is classified as supplies and services revenue.

### **Segment and Geographic Information**

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



**Table of Contents**

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

Information regarding our sales and long-lived assets in the U.S. and in countries outside the U.S. is contained in *Note 16 Segment, Customer and Geographic Information* of our consolidated financial statements included in this report and is incorporated in this section by this reference.

**Revenue by Product Family and Product Category**

For the years ended December 31, 2010, 2009 and 2008, revenue from our four product families as a percent of total revenue was approximately as follows:

	Year Ended December 31,		
	2010	2009	2008
Neurology	45%	39%	34%
Hearing	32%	40%	41%
Newborn Care	19%	16%	19%
Other	4%	5%	6%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

We also look at revenue as either being generated from sales of Devices and Systems, which are generally non-recurring, or related Supplies and Services, which are generally recurring. The products that are attributable to these categories are described above. Revenue from Devices and Systems, and Supplies and Services, as a percent of total revenue for the years ending December 31, 2010, 2009 and 2008 is as follows:

	Year Ended December 31,		
	2010	2009	2008
Devices and Systems	62%	58%	63%
Supplies and Services	37%	40%	35%
Other	1%	2%	2%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

In 2010, 2009 and 2008, sales to no single end-user customer comprised more than 10% of our revenue, and revenue from services was less than 10% of our revenue.

**Backlog**

As of December 31, 2010, our backlog was approximately \$6.0 million, compared to \$8.9 million at December 31, 2009 and \$2.1 million at December 31, 2008.

**Marketing and Sales****Marketing**

Our marketing strategy differentiates our products by their level of quality, performance, and customer benefit. We educate customers and potential customers worldwide about our products through several traditional methods, including, but not limited to:

Trade conference exhibits;

Edgar Filing: NATUS MEDICAL INC - Form 10-K

Direct presentations to healthcare professionals;

Publications in professional journals and trade magazines;

13

## **Table of Contents**

The Internet via our website, *www.natus.com*;

Print and direct mail advertising campaigns; and

Sponsorship of and participation in clinical education seminars and workshops. Educational efforts directed at government agencies, physicians, and clinicians about the benefits of universal screening in terms of patient outcomes and long-term treatment costs are a key element of our marketing strategy.

### ***Domestic Direct and Distributor Sales***

We sell our products in the United States primarily through a direct sales organization. We believe this direct sales organization allows us to maintain a higher level of customer service and satisfaction than would otherwise be possible by other distribution methods. We also sell certain products under private label and distribution arrangements.

Domestic revenue as a percent of total revenue was 58%, 66%, and 69% in 2010, 2009 and 2008, respectively.

As a percent of total revenue, domestic sales through our direct and other sales channels, respectively, was 52% and 6% in 2010, 59% and 7% in 2009, and 62% and 7% in 2008.

### ***International Direct and Distributor Sales***

We sell some of our products outside the U.S. through direct sales channels in Canada and in the French and German speaking regions of Europe, in Denmark, and in parts of Latin America; we sell other products in those regions and into more than 100 other countries through a distributor sales channel.

International revenue as a percent of total revenue was 42%, 34%, and 31% in 2010, 2009 and 2008, respectively.

As a percent of total revenue, international sales through our direct and other sales channels, respectively, was 17% and 25% in 2010, 11% and 23% in 2009, and 16% and 15% in 2008.

We sell products to our distributors under substantially the same terms as sales through our direct sales channels. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped ex works, in which title and risk of loss are assumed by the distributor at the shipping point. Distributors are generally given exclusive rights in their territories to purchase products from Natus and resell to end users or subdistributors. Our distributors typically perform marketing, sales, and technical support functions in their respective markets. Each distributor may sell Natus products to their customer directly, via other distributors or resellers, or both. We actively train our distributors in product marketing, selling, and technical service techniques.

### ***Seasonality in Revenue***

We experience seasonality in our revenue. Our revenue typically drops from our fourth quarter to our first quarter. This seasonality results from the purchasing habits of our hospital-based customers, whose purchases are often governed by calendar year budgets, and the manner in which our direct sales force is compensated, as their compensation is based on annual sales plans that are tied to our December year end.

### ***Group Purchasing Organizations***

More than 90% of the hospitals in the U.S. are members of group purchasing organizations ( GPO s), which negotiate volume purchase agreements for member hospitals, group practices, and other clinics. Direct

## **Table of Contents**

purchases by GPO members accounted for approximately 18%, 24% and 31% of our revenue in 2010, 2009 and 2008, respectively. Direct purchases by members of one GPO, Novation, accounted for approximately 6%, 8% and 10% of our revenue in 2010, 2009 and 2008, respectively.

### ***Third-Party Reimbursement***

In the U.S., health care providers generally rely on third-party payors, including private health insurance plans, federal Medicare, state Medicaid, and managed care organizations, to reimburse all or part of the cost of the procedures they perform. Third-party payors can affect the pricing or the relative attractiveness of our products by regulating the maximum amount of reimbursement these payors provide for services utilizing our products. For this reason, we are not able to measure a reimbursement success rate for our products.

### ***Customer Service and Support***

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

### **Manufacturing**

Other companies manufacture a significant portion of the components used in our products; however, we perform final assembly, testing, and packaging of most of the devices ourselves to control quality and manufacturing efficiency. We also use contract vendors to manufacture some of our disposable supply and medical device products. We perform regular quality audits of these vendors.

We purchase materials and components from qualified suppliers that are subject to our quality specifications and inspections. We conduct quality audits of our key suppliers, several of which are experienced in the supply of components to manufacturers of finished medical devices, or supplies for use with medical devices. Most of our purchased components are available from more than one supplier.

Our manufacturing, service, and repair facilities are subject to periodic inspection by federal, state, and foreign regulatory authorities. Our quality assurance system is subject to regulation by the FDA and other state government agencies. We are required to conduct our product design, testing, manufacturing, and control activities in conformance with the FDA's quality system regulations and to maintain our documentation of these activities in a prescribed manner. In addition, our production facilities have received ISO 13485 certification. ISO 13485 certification standards for quality operations have been developed to ensure that medical device companies meet the standards of quality on a worldwide basis. We have also received the EC Certificate pursuant to the European Union Medical Device Directive 93/42/EEC, which allows us to place a CE mark on our products.

### **Research and Development**

We are committed to introducing new products and supporting current product offerings in our markets through a combination of internal as well as external efforts that are consistent with our corporate strategy.

*Internal product development capabilities.* We believe that product development capabilities are essential to provide our customers with new product offerings. We plan to leverage our core technologies by introducing product line extensions as well as new product offerings.

*Partnerships that complement our expertise.* We continue to seek strategic partners in order to develop products that may not otherwise be available to us. By taking advantage of our core competencies, we believe that we can bring products to market in an efficient manner and leverage our distribution channels.

## **Table of Contents**

*New opportunities through technology acquisition.* We continue to evaluate new, emerging, and complementary technologies in order to identify new product opportunities. With our knowledge of our current markets we believe that we can effectively develop technologies into successful new products.

Our research and development expenses were \$21.3 million or 9.7% of total revenue in 2010, \$16.7 million or 10.0% of total revenue in 2009, and \$15.5 million or 9.6% of total revenue in 2008.

## **Proprietary Rights**

We protect our intellectual property through a combination of patent, copyright, trade secret, and trademark laws. We attempt to protect our intellectual property rights by filing patent applications for new features and products we develop. We enter into confidentiality or license agreements with our employees, consultants, and corporate partners, and seek to control access to our intellectual property, distribution channels, documentation, and other proprietary information. However, we believe that these measures afford only limited protection.

The intellectual rights to some of the original patents for technology incorporated into our products are now in the public domain. However, we do not consider these patents, or any currently viable patent or related group of patents, to be of such importance that their expiration or termination would materially affect our business.

We capitalize the cost of purchased technology and intellectual property, as well as certain costs incurred in obtaining patent rights, and amortize these costs over the estimated economic lives of the related assets.

## **Competition**

We sell our products in competitive and rapidly evolving markets. We face competition from other companies in all of our product lines. Our competitors range from small privately-held companies to multinational corporations and their product offerings vary in scope and breadth. We do not believe that any single competitor is dominant in any of our product lines.

We derive a significant portion of our revenue from the sale of disposable supplies that are used with our medical devices. In the U.S., we sell our supply products in a mature market. Because these products can generate high margins, we expect that our products, particularly our hearing screening supply products, could face increasing competition, including competitors offering lower prices, which could have an adverse affect on our revenue and margins.

We believe the principal factors that will draw clinicians and other buyers to our products, include:

Level of specificity, sensitivity, and reliability of the product;

Time required to obtain results with the product, such as to test for or treat a clinical condition;

Relative ease of use of the product;

Depth and breadth of the products features;

Quality of customer support for the product;

Frequency of product updates;



Edgar Filing: NATUS MEDICAL INC - Form 10-K

Extent of third-party reimbursement of the cost of the product or procedure;

Extent to which the products conform to standard of care guidelines; and

Price of the product.

## **Table of Contents**

We believe that our primary competitive strength relates to the functionality and reliability of our products. Different competitors may have competitive advantages in one or more of the categories listed above and they may be able to devote greater resources to the development, promotion, and sale of their products.

### **Government Regulation**

#### ***FDA's Premarket Clearance and Approval Requirements***

Unless an exemption applies, the medical devices we sell in the United States, with the exception of some disposable products, must first receive one of the following types of FDA premarket review authorizations under the Food, Drug, and Cosmetics Act, as amended:

Clearance via Section 510(k); or

Premarket approval via Section 515 if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA's 510(k) clearance process usually takes from three to 12 months, but can take longer. The process of obtaining premarket approval via Section 515 is much more costly, lengthy, and uncertain. Premarket approval generally takes from one to three years, but can take longer. We cannot be sure that the FDA will ever grant either 510(k) clearance or premarket approval for any product we propose to market in the United States.

The FDA decides whether a device must undergo either the 510(k) clearance or premarket approval process based upon statutory criteria. These criteria include the level of risk that the Agency perceives to be associated with the device and a determination of whether the product is a type of device that is substantially equivalent to devices that are already legally marketed. The FDA places devices deemed to pose relatively less risk in either Class I or Class II, which requires the manufacturer to submit a premarket notification requesting 510(k) clearance, unless an exemption applies. The premarket notification under Section 510(k) must demonstrate that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a previously cleared 510(k) device or a device that was in commercial distribution before May 28, 1976 for which the FDA has not yet called for the submission of premarket approval applications.

The FDA places devices deemed to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed to be not substantially equivalent to a predicate device, in its Class III classification. The FDA requires these devices to undergo the premarket approval process via Section 515 in which the manufacturer must prove the safety and effectiveness of the device. A premarket approval application must provide extensive pre-clinical and clinical trial data.

The FDA may require results of clinical trials in support of a 510(k) submission and generally requires clinical trial results for a premarket approval application. In order to conduct a clinical trial on a significant-risk device, the FDA requires manufacturers to apply for and obtain, in advance, an investigational-device exemption. The investigational-device exemption application must be supported by appropriate data, such as animal and laboratory testing results. If the FDA and the Institutional Review Boards at the clinical trial sites approve the investigational-device exemption application for a significant-risk device, the manufacturer may begin the clinical trial. An investigational-device exemption approval provides for a specified clinical protocol, including the number of patients and study sites. If the manufacturer deems the product a non-significant risk device, the product will be eligible for more abbreviated investigational-device exemption requirements. If the Institutional Review Boards at the clinical trial sites concur with the non-significant risk determination, the manufacturer may begin the clinical trial.

We received approval for our Olympic Cool-Cap product as a Class III device from the FDA through the premarket approval process. Most of our other products have been cleared by the FDA as Class II devices. Some of our disposable products and newborn care products, such as our neonatal headshields and oxygen delivery systems, have received FDA clearance as Class I devices.

## **Table of Contents**

### ***FDA Regulation***

Numerous FDA regulatory requirements apply to our products. These requirements include:

FDA quality system regulations which require manufacturers to create, implement, and follow design, testing, control, documentation, and other quality assurance procedures;

Medical device reporting regulations, which require that manufacturers report to the FDA certain types of adverse and other events involving their products; and

FDA general prohibitions against promoting products for unapproved uses.

Class II and III devices may also be subject to special controls applied to them, such as performance standards, post-market surveillance, patient registries, and FDA guidelines that may not apply to Class I devices. We believe we are in compliance with applicable FDA guidelines, but we could be required to change our compliance activities or be subject to other special controls if the FDA changes existing regulations or adopts new requirements.

We are subject to inspection and market surveillance by the FDA to determine compliance with regulatory requirements. If the FDA finds that we have failed to adequately comply, the Agency can institute a wide variety of enforcement actions, including:

Issuance of a Form 483 citation;

Fines, injunctions, and civil penalties;

Recall or seizure of our products;

Issuance of public notices or warnings;

Imposition of operating restrictions, partial suspension, or total shutdown of production;

Refusal of our requests for 510(k) clearance or pre-market approval of new products;

Withdrawal of 510(k) clearance or pre-market approval already granted; or

Criminal prosecution.

The FDA also has the authority to require us to repair, replace, or refund the cost of any medical device manufactured or distributed by us.

### ***Other Regulations***

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

We also must comply with numerous additional federal, state, and local laws relating to matters such as safe working conditions, manufacturing practices, environmental protection, biohazards, fire hazard control, and hazardous substance disposal. We believe we are currently in compliance with such regulations.

Countries outside of the U.S. regulate medical devices in a manner similar to that of the FDA. Our manufacturing facilities are subject to audit and have been certified to be ISO 13485:2003, Medical Device Directive 93/42/EEC, and CMDCAS compliant, which allows us to sell our products in Canada, Europe, and other territories around the world. Our manufacturing facilities in North America are subject to ISO 13485 inspections by our notified body, British Standards Institution Management Systems, and by other notified bodies outside of North America. We plan to seek approval to sell our products in additional countries, while maintaining our current approvals. The time and cost of obtaining new, and maintaining existing, market authorizations from countries outside of North America, and the requirements for licensing products in these countries may differ significantly from FDA requirements.

### **Employees**

On December 31, 2010, we had approximately 750 full time employees worldwide. In Argentina, some of our production employees are represented by labor unions; none of our other employees are so represented. We have not experienced any work stoppages and consider our relations with our employees to be good.

**Table of Contents****Executive Officers**

The following table lists our executive officers and their ages as of March 1, 2011:

<b>Name</b>	<b>Age</b>	<b>Position(s)</b>
James B. Hawkins	55	Chief Executive Officer and Director
John T. Buhler	50	President and Chief Operating Officer
Steven J. Murphy	59	Vice President Finance and Chief Financial Officer
William L. Mince	59	Vice President North American Operations
Kenneth M. Traverso	50	Vice President Marketing and Sales
D. Christopher Chung, M.D.	47	Vice President Medical Affairs and R&D

*James B. Hawkins* has served as Chief Executive Officer, and as a member of the Board of Directors, since joining Natus in April 2004, and formerly as President from April 2004 through January 2011. Mr. Hawkins has over 25 years of combined medical device and financial management experience. Prior to joining Natus, he was President and Chief Executive Officer of Nasdaq-traded Invivo Corporation for 19 years. Invivo Corporation, a maker of multi-parameter vital sign monitoring equipment used in hospitals, was acquired in early 2004 by Intermagnetics General Corporation. He earned a Bachelor of Commerce degree, specialized in Management from Santa Clara University and a Masters of Business Administration Finance degree from San Francisco State University. Mr. Hawkins is a Director of Iridex Corp.

*John T. Buhler* has served as President and Chief Operating Officer since February, 2011. Mr. Buhler was employed by Avantis Medical Systems as President and Chief Executive officer from January 2011 to February 2011. He held various positions at SenoRx from May 2008 through July 2010, including President and Chief Executive Officer from March 2010 through July 2010, President and Chief Operating Officer from October 2009 to March 2010, Senior Vice President and Chief Commercial Officer from April 2009 to October 2009, Vice President of Global Sales and Business Development from October 2008 until April 2009, and Vice President of International Sales and Business Development from May 2008 until October 2008. From August 2005 to May 2008, Mr. Buhler served as President and Chief Executive Officer at Ultrasonix Medical Corporation, a privately held manufacturer of diagnostic ultrasound imaging equipment. From 1998 to 2005, Mr. Buhler held various positions at General Electric, last serving as Vice President and General Manager of GE's Ultrasound Performance Technologies Division in Shanghai, China.

*Steven J. Murphy* has served as Chief Financial Officer since February 2006, Vice President Finance since June 2003, and joined Natus in September 2002 as Director of Finance. From February 2002 through September 2002, Mr. Murphy was interim Controller at Travel Nurse International, a temporary staffing firm that was acquired by Medical Staffing Network in December 2002. From October 1998 through January 2002, Mr. Murphy was Controller of AdvisorTech Corporation, an international software development company providing IT-based solutions in the field of investments, where he was responsible for financial reporting of domestic, Asian and European operations with significant reporting responsibilities to the board of directors and investor groups. From 1996 to 1998 he was Vice President Finance of RWS Group, LLC, an international service company providing management of language-related projects. Mr. Murphy holds a Bachelor of Science degree in Business Administration from California State University, Chico. Mr. Murphy is a certified public accountant.

*William L. Mince* has served as our Vice President, North American Operations since September 2007 and joined Natus as Vice President Operations in October 2002. From November 2000 to September 2002, Mr. Mince served as President and Founder of My Own Jukebox, an Internet retail company. From July 1998 to October 2000, Mr. Mince was a consultant with the majority of his time spent as Senior Vice President Network Solutions for Premier Retail Network, a media broadcasting company. From July 1997 to June 1998, Mr. Mince served as President and Chief Operating Officer of Ophthalmic Imaging Systems, a publicly-held medical device company. From July 1994 to June 1997, Mr. Mince was Vice President Operations with Premier Retail Network. From May 1988 to June 1994, Mr. Mince was Director of Operations for Nellcor, a medical device company. Mr. Mince holds a Bachelor of Science degree in Business Administration from the University of Redlands and a Masters of Business Administration degree from National University.

---

## **Table of Contents**

*Kenneth M. Traverso* has served as our Vice President Marketing and Sales since April 2002. From September 2000 to April 2002, he served as our Vice President Sales. From October 1999 to July 2000, Mr. Traverso served as President of DinnerNow.com Inc., an internet aggregator for the restaurant industry. From January 1998 to September 1999, Mr. Traverso served as Vice President Sales, Western Region of Alere Medical, an outpatient chronic disease management company. From May 1995 to January 1998, Mr. Traverso served as Vice President Marketing and Sales of AbTox, Inc., a low temperature sterilization company. From August 1990 to May 1995, Mr. Traverso served in various capacities at Natus, including Vice President Sales. From September 1984 to July 1990 Mr. Traverso served various positions at Nellcor, a medical device company, including Regional Sales Manager, Western Region. Mr. Traverso holds a Bachelor of Science degree in Administration & Marketing from San Francisco State University.

*D. Christopher Chung, M.D.*, has served as our Vice President Medical Affairs and R&D since June 2003, and has served as our Vice President Medical Affairs since February 2003. Dr. Chung also served as our Medical Director from October 2000 to February 2003. From August 2000 to December 2007, Dr. Chung also served as a Pediatric Hospitalist at the California Pacific Medical Center in San Francisco. Dr. Chung has been a member of the Medical Advisory Board of eHealth Global Technologies, Inc. since April 2007 and has served as a member of their Board of Directors since November 2007. From June 1997 to June 2000, Dr. Chung trained as a pediatric resident at Boston Children's Hospital and Harvard Medical School. From May 1986 to July 1993, Dr. Chung worked as an Engineer at Nellcor, a medical device company. Dr. Chung holds a Bachelor of Arts degree in Computer Mathematics from the University of Pennsylvania and a Doctor of Medicine degree from the Medical College of Pennsylvania-Hahnemann University School of Medicine. He is a licensed physician and is a Fellow of the American Academy of Pediatrics.

## **Other Information**

Natus was incorporated in California in May 1987 and reincorporated in Delaware in August 2000.

We maintain corporate offices at 1501 Industrial Road, San Carlos, California 94070. Our telephone number is (650) 802-0400. We maintain a corporate website at [www.natus.com](http://www.natus.com). References to our website address do not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

We make available, free of charge on our corporate website, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and all amendments to these reports, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act. We also show detail about stock trading by corporate insiders by providing access to SEC Forms 3, 4 and 5. This information may also be obtained from the SEC's on-line database, which is located at [www.sec.gov](http://www.sec.gov). Our common stock is traded on the Nasdaq Stock Market under the symbol **BABY**.

## **ITEM 1A. Risk Factors**

**We have completed a number of acquisitions and expect to complete additional acquisitions in the future. There are numerous risks associated with acquisitions and we may not achieve the expected benefit of any of our acquisitions**

Our acquisitions of products, technology assets, or businesses may have a negative impact on our business if we fail to achieve the anticipated financial, strategic, and other benefits of acquisitions or investments, and our operating results may suffer because of this.

Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008; Hawaii Medical and Alpine Biomed in 2009, and Medix in 2010.

---

**Table of Contents**

We expect to continue to pursue opportunities to acquire other businesses in the future. The acquisitions that we have completed may not result in improved operating results for us, or in our achieving a financial condition superior to that which we would have achieved had we not completed them. Our results of operations may be adversely impacted by costs associated with our acquisitions, including one-time charges associated with restructurings. Further, our acquisitions could fail to produce the benefits that we anticipate, or could have other adverse effects that we currently do not foresee. In addition, some of the assumptions that we have relied upon, such as achievement of operating synergies, may not be realized. In this event, one or more of the acquisitions could result in reduced earnings of Natus as compared to the earnings that would have been achieved by Natus if the acquisition had not occurred.

We have assumed contingent obligations associated with earnout provisions in some of our acquisitions. We believe these provisions help us to negotiate mutually agreeable purchase terms between us and the sellers. However, a disagreement between us and a seller about the terms of an earnout provision could result in our paying more for an acquisition than we intended. For example, such a disagreement arose in connection with our acquisition of Alpine Biomed, which we have subsequently resolved. The stockholders of Schwarzer Neurology have recently asserted claims relating to the earnout provision of our agreement with those stockholders that have not yet been resolved. Disputes over these types of contingent obligations may not be resolved on terms that are favorable to us and the payment of additional purchase consideration could impact our results of operations and financial position.

We have incurred indebtedness to fund some of our acquisitions. The use of debt to fund our acquisitions may have an adverse impact on our liquidity and cause us to place more reliance on cash flow from operations for our liquidity. If our cash flow from operations is not sufficient for our needs, our business could be adversely affected. If we are required to seek additional external financing to support our need for cash to fund future acquisitions, we may not have access to financing on terms that are acceptable to us, or at all. Alternatively, we may feel compelled to access additional financing on terms that are dilutive to existing holders of our common stock or that include covenants that restrict our business, or both. If the recent lack of liquidity in credit markets persists into the future, our ability to obtain debt financing for future acquisitions may be impaired.

If we fail to successfully manage the combined operations of Natus and the businesses we have acquired, we may not realize the potential benefits of our acquisitions. Our corporate headquarters are located in San Carlos, California. We also have the following operating divisions: Olympic in Washington; Neurocom in Oregon; Bio-logic in Illinois; Neometrics in New York; Xltek and Stellate in Canada; Medix in Argentina; Alpine Biomed in Denmark; Fischer-Zoth, Schwarzer Neurology, IT-Med, and Alpine Biomed Germany (collectively Natus Europe ) in Germany; and Deltamed and Alpine Biomed France (collectively Natus France ) in France. If we fail to manage these disparate operations effectively, our results of operations could be harmed, employee morale could decline, key employees could leave, and customers could cancel existing orders or choose not to place new ones. In addition, we may not achieve the synergies or other benefits of these and future acquisitions that we anticipate. We may encounter the following additional difficulties and delays involved in integrating and managing these operations, and the operations of companies we may acquire:

Failure of customers to continue using the products and services of the combined company;

Failure to successfully develop the acquired technology into the desired products or enhancements;

Assumption of unknown liabilities;

Failure to understand products or technologies with which we have limited previous experience;

Failure to compete effectively in new markets;

Decreased liquidity, restrictive bank covenants, and incremental financing costs associated with debt we may incur to complete future acquisitions; and

Edgar Filing: NATUS MEDICAL INC - Form 10-K

Diversion of the attention of management from other ongoing business concerns.



---

**Table of Contents**

Our reported operating results may suffer because of impairment charges incurred to write down the carrying amount of intangible assets, including goodwill, generated as a result of the acquisitions.

**Our growth in recent years has depended substantially on the completion of acquisitions and we may not be able to complete acquisitions of this nature or of a relative size in the future to support a similar level of growth**

The acquisitions that we have completed have been the primary source of our growth in revenue in recent years. We expend considerable effort in seeking to identify attractive acquisition candidates and, upon doing so, to convince the potential target to consider a sale to us and, ultimately, to negotiate mutually agreeable acquisition terms. If we are not successful in these efforts in the future, our growth rate will not increase at a rate corresponding to that which we have achieved in recent years. Further, as we grow larger it will be necessary to complete the acquisition of larger companies and product lines to support a growth similar to that which we have achieved in the past. The market for attractive acquisitions is competitive and others with greater financial resources than we have may be better positioned than we are to acquire desirable targets. Further, we may not be able to negotiate acquisition terms with target companies that will allow us to achieve positive financial returns from the transaction.

**Adverse economic conditions in markets in which we operate may harm our business**

Unfavorable changes in U.S. and international economic environments may adversely affect our business and financial results. Economic conditions in the countries in which we operate and sell products worsened and global financial markets subsequently experienced significant volatility and declines throughout much of 2009. Although these conditions improved in 2010, we are unable to foresee when, or if, these factors might return to historical levels. During challenging economic times, and in tight credit markets, our customers may delay or reduce capital expenditures. This could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies, and increased price competition, all of which could impact our results of operations and financial condition. In addition, we expect these factors will cause us to be more cautious in evaluating potential acquisition opportunities, which could hinder our ability to grow through acquisition while these conditions persist.

**We have initiated changes to our information systems that could disrupt our business and our financial results.**

We plan to continuously improve our enterprise resource planning, customer relationship management, and document lifecycle management systems to support the form, functionality, and scale of our business. These types of transitions frequently prove disruptive to the underlying business of an enterprise and may cause us to incur higher costs than we anticipate. Failure to manage a smooth transition to the new systems and the ongoing operations and support of the new systems could materially harm our business operations.

For example, we are currently in the process of implementing the rollout of an enterprise resource planning application ( ERP ) in our European operating divisions. Until we have completed this ERP implementation, we will be dependent on multiple platforms. We may experience difficulties in implementing the ERP and we may fail to gain the efficiencies the implementation is designed to produce. The implementation could also be disruptive to our operations, including the ability to timely ship and track product orders to customers, project inventory requirements, manage our supply chain and otherwise adequately service our customers.

**Future changes in technology or market conditions could result in adjustments to our recorded asset balance for intangible assets, including goodwill, resulting in additional charges that could significantly impact our operating results**

Our balance sheet includes significant intangible assets, including goodwill and other acquired intangible assets. The determination of related estimated useful lives and whether these assets are impaired involves significant judgment. Our ability to accurately predict future cash flows related to these intangible assets might

---

**Table of Contents**

be hindered by events over which we have no control. Due to the highly competitive nature of the medical device industry, new technologies could impair the value of our intangible assets if they create market conditions that adversely affect the competitiveness of our products. Any future determination that these assets are carried at greater than their fair value could result in substantial impairment charges, which could significantly impact our operating results.

**We may not be able to preserve the value of our intellectual property because we may not be able to protect access to it or we may lose our intellectual property rights due to expiration of our licenses or patents**

If we fail to protect our intellectual property rights or if our intellectual property rights do not adequately cover the technology we employ, other medical device companies could sell products with features similar to ours, and this could reduce demand for our products. We protect our intellectual property through a combination of patent, copyright, trade secret and trademark laws. Despite our efforts to protect our proprietary rights, others may attempt to copy or otherwise improperly obtain and use our products or technology. Policing unauthorized use of our technology is difficult and expensive, and we cannot be certain that the steps we have taken will prevent misappropriation. Our means of protecting our proprietary rights may be inadequate. Enforcing our intellectual property rights could be costly and time consuming and may divert our management's attention and resources. Failing to enforce our intellectual property rights could also result in the loss of those rights.

**If health care providers are not adequately reimbursed for procedures conducted with our devices or supplies, or if reimbursement policies change adversely, we may not be successful marketing and selling our products or technologies**

Clinicians, hospitals, and government agencies are unlikely to purchase our products if they are not adequately reimbursed for the procedures conducted with our devices or supplies. Unless a sufficient amount of conclusive, peer-reviewed clinical data about our products has been published, third-party payors, including insurance companies and government agencies, may refuse to provide reimbursement. Furthermore, even if reimbursement is provided, it may not be adequate to fully compensate the clinicians or hospitals. Some third-party payors may impose restrictions on the procedures for which they will provide reimbursement. If health care providers cannot obtain sufficient reimbursement from third-party payors for our products or the screenings conducted with our products, we may not achieve significant market acceptance of our products. Acceptance of our products in international markets will depend upon the availability of adequate reimbursement or funding within prevailing healthcare payment systems. Reimbursement, funding, and healthcare payment systems vary significantly by country. We may not obtain approvals for reimbursement in a timely manner or at all.

Adverse changes in reimbursement policies in general could harm our business. We are unable to predict changes in the reimbursement methods used by third-party health care payors, particularly those in countries and regions outside the U.S. For example, some payors are moving toward a managed care system in which providers contract to provide comprehensive health care for a fixed cost per person. In a managed care system, the cost of our products may not be incorporated into the overall payment for patient care or there may not be adequate reimbursement for our products separate from reimbursement for other procedures.

**Healthcare reforms, changes in healthcare policies, and changes to third-party reimbursements for our products may affect demand for our products**

In March 2010 the U. S. government signed into law the *Patient Protection and Affordable Care Act* and the *Health Care & Education Reconciliation Act*. These laws are intended to, among other things, curb rising healthcare costs, including those that could significantly affect reimbursement for our products. The policies supporting these laws include: basing reimbursement policies and rates on clinical outcomes; the comparative effectiveness and costs of different treatment technologies and modalities; imposing price controls; and other measures. Future significant changes in the healthcare systems in the United States or elsewhere could also have a negative impact on the demand for our current and future products. These include changes that may reduce

---

## **Table of Contents**

reimbursement rates for our products and changes that may be proposed or implemented by the U.S. Presidential administration or Congress.

There are numerous steps required to implement these laws. Because of the unsettled nature of these reforms, we cannot predict what additional healthcare reforms will be implemented at the federal or state level, or the effect that any future legislation or regulation will have on our business. There is also considerable uncertainty of the impact of these reforms on the medical device market as a whole. If we fail to effectively react to the implementation of health care reform, our business may be adversely affected. In addition, if the excise tax on the sale of medical devices is imposed as enacted, this could increase our costs and have an adverse effect on our results of operations, financial position, and cash flows.

### **If we fail in our efforts to educate clinicians, government agency personnel, and third-party payors on the effectiveness of our products, we may not achieve future sales growth**

It is critical to the success of our sales efforts that we educate a sufficient number of clinicians, hospital administrators, and government agencies about our products and the costs and benefits of their use. The commercial success of our products depends upon clinician, government agency, and other third-party payer confidence in the economic and clinical benefits of our products as well as their comfort with the efficacy, reliability, sensitivity and specificity of our products. We believe that clinicians will not use our products unless they determine, based on published peer-reviewed journal articles and experience, that our products provide an accurate and cost-effective alternative to other means of testing or treatment. Our customers may choose to use competitive products, which may be less expensive or may provide faster results than our devices. Clinicians are traditionally slow to adopt new products, testing practices and clinical treatments, partly because of perceived liability risks and the uncertainty of third-party reimbursement. If clinicians, government agencies and hospital administrators do not adopt our products, we may not maintain profitability. Factors that may adversely affect the medical community's acceptance of our products include:

Publication of clinical study results that demonstrate a lack of efficacy or cost-effectiveness of our products;

Changing governmental and physician group guidelines;

Actual or perceived performance, quality, price, and total cost of ownership deficiencies of our products relative to other competitive products;

Our ability to maintain and enhance our existing relationships and to form new relationships with leading physicians, physician organizations, hospitals, state laboratory personnel, and third-party payers;

Changes in state and third-party payer reimbursement policies for our products; and

Repeal of laws requiring universal newborn hearing screening and metabolic screening.

### **Sales through group purchasing organizations and sales to high volume purchasers may reduce our average selling prices, which could reduce our operating margins**

We have entered, and expect in the future to enter into agreements with customers who purchase high volumes of our products. Our agreements with these customers may contain discounts from our normal selling prices and other special pricing considerations, which could cause our operating margins to decline. In addition, we have entered into agreements to sell our products to members of GPOs, which negotiate volume purchase prices for medical devices and supplies for member hospitals, group practices and other clinics. While we make sales directly to GPO members, the GPO members receive volume discounts from our normal selling price and may receive other special pricing considerations from us. Sales to members of all GPOs accounted for approximately 18%, 24% and 31% of our total revenue during 2010, 2009 and 2008, respectively, and sales to members of one GPO, Novation, accounted for approximately 6%, 8% and 10% of our total revenue in 2010, 2009 and 2008, respectively. Other of our existing customers may be members of GPOs with which we do not



## **Table of Contents**

have agreements. Our sales efforts through GPOs may conflict with our direct sales efforts to our existing customers. If we enter into agreements with new GPOs and some of our existing customers begin purchasing our products through those GPOs, our operating margins could decline.

### **Demand for some of our products depends on the capital spending policies of our customers, and changes in these policies could harm our business**

A majority of customers for our products are hospitals, physician offices, and clinics. Many factors, including public policy spending provisions, available resources, and economic cycles have a significant effect on the capital spending policies of these entities and therefore the amount that they can spend on our equipment products. If budget resources limit the capital spending of our customers, they will be unlikely to either purchase any new equipment from us or upgrade to any of our newer equipment products. Lack of liquidity in credit markets and uncertainty about future economic conditions can have an adverse effect on the spending patterns of our customers. These factors can have a significant adverse effect on the demand for our products.

### **Our markets are very competitive and in the United States we sell certain of our products in a mature market**

We face competition from other companies in all of our product lines. Our competitors range from small privately held companies to multinational corporations and their product offerings vary in scope and breadth. We do not believe that any single competitor is dominant in any of our product lines.

The markets for certain of our products in the U.S., including the newborn hearing screening and EEG monitoring markets, are mature and we are unlikely to see significant growth for such products in the U.S. In the U.S. we derive a significant portion of our revenue from the sale of disposable supplies that are used with our hearing screening devices. Because these disposable supply products can generate high margins, we expect that our products, particularly our hearing screening disposable supply products, could face increasing competition, including competitors offering lower prices, which could have an adverse affect on our revenue and margins.

Our competitors may have certain competitive advantages, which include the ability to devote greater resources to the development, promotion, and sale of their products. Consequently, we may need to increase our efforts, and related expenses for research and development, marketing, and selling to maintain or improve our position.

We expect recurring sales to our existing customers to generate a majority of our revenue in the future, and if our existing customers do not continue to purchase products from us, our revenue may decline.

### **Our operating results may decline if we do not succeed in developing, acquiring, and marketing additional products or improving our existing products**

We intend to develop additional products and technologies, including enhancements of existing products, for the screening, detection, treatment, monitoring and tracking of common medical ailments. Developing new products and improving our existing products to meet the needs of current and future customers requires significant investments in research and development. If we fail to successfully sell new products, update our existing products, or timely react to changes in technology, our operating results may decline as our existing products reach the end of their commercial life cycles.

### **Our plan to expand our international operations will result in increased costs and is subject to numerous risks; if our efforts are not successful, this could harm our business**

We have expanded our international operations through acquisitions and plan to expand our international sales and marketing efforts to increase sales of our products in foreign countries. We may not realize

## **Table of Contents**

corresponding growth in revenue from growth in international unit sales, due to the lower average selling prices we receive on sales outside of the U.S. Even if we are able to successfully expand our international selling efforts, we cannot be certain that we will be able to create or increase demand for our products outside of the U.S. Our international operations are subject to other risks, which include:

Impact of possible recessions in economies outside the U.S.;

Political and economic instability, including instability related to war and terrorist attacks;

Contractual provisions governed by foreign law, such as local law rights to sales commissions by terminated distributors;

Decreased healthcare spending by foreign governments that would reduce international demand for our products;

Continued strengthening of the U.S. dollar relative to foreign currencies that could make our products less competitive because approximately half of our international sales are denominated in U.S. dollars;

Greater difficulty in accounts receivable collection and longer collection periods;

Difficulties of staffing and managing foreign operations;

Reduced protection for intellectual property rights in some countries and potentially conflicting intellectual property rights of third parties under the laws of various foreign jurisdictions;

Difficulty in obtaining and maintaining foreign regulatory approval; and

Attitudes by clinicians, and cost reimbursement policies, towards use of disposable supplies that are potentially unfavorable to our business.

In particular, our international sales could be adversely affected by a strengthening of the U.S. dollar relative to other foreign currencies, which makes our products more costly to international customers for sales denominated in U.S. dollars.

### **Our operating results may suffer because of our exposure to foreign currency exchange rate fluctuations**

Substantially all of our sales contracts with our U.S. based customers provide for payment in U.S. dollars. With the exception of our Canadian operations, substantially all of the revenue and expenses of our foreign subsidiaries are denominated in the applicable foreign currency. To date we have executed only limited foreign currency contracts to hedge these currency risks. Our future revenue and expenses may be subject to volatility due to exchange rate fluctuations that could result in foreign exchange gains and losses associated with foreign currency transactions and the translation of assets and liabilities denominated in foreign currencies.

Substantially all our sales from our U.S. operations to our international distributors provide for payment in U.S. dollars. A strengthening of the U.S. dollar relative to other foreign currencies could increase the effective cost of our products to our international distributors as their functional currency is typically not the U.S. dollar. This could have a potential adverse effect on our ability to increase or maintain average selling prices of our products to our foreign-based customers.

**If guidelines mandating universal newborn hearing screening do not continue to develop in foreign countries and governments do not mandate testing of all newborns as we anticipate, or if those guidelines have a long phase-in period, our sales of newborn hearing screening products may not achieve the revenue growth we have achieved in the past**

We estimate that approximately 95% of the children born in the U.S. are currently being tested for hearing impairment prior to discharge from the hospital. To date, there has been only limited adoption of newborn hearing screening prior to hospital discharge by foreign governments, and when newborn hearing screening

---

**Table of Contents**

programs are enacted by foreign governments there can be a phase-in period spanning several years. The widespread adoption of guidelines depends, in part, on our ability to educate foreign government agencies, neonatologists, pediatricians, third-party payors, and hospital administrators about the benefits of universal newborn hearing screening as well as the use of our products to perform the screening and monitoring. Our revenue from our newborn hearing screening product lines may not grow if foreign governments do not require universal newborn hearing screening prior to hospital discharge, if physicians or hospitals are slow to comply with those guidelines, or if governments provide for a lengthy phase-in period for compliance.

**Because we rely on distributors or sub-distributors to sell our products in most of our markets outside of the U.S., our revenue could decline if our existing distributors reduce the volume of purchases from us, or if our relationship with any of these distributors is terminated**

We currently rely on our distributors or sub-distributors for a majority of our sales outside the U.S. Some distributors also assist us with regulatory approvals and education of clinicians and government agencies. We intend to continue our efforts to increase our sales in Europe, Japan, and other developed countries. If we fail to sell our products through our international distributors, we would experience a decline in revenues unless we begin to sell our products directly in those markets. We cannot be certain that we will be able to attract new international distributors to market our products effectively or provide timely and cost-effective customer support and service. Even if we are successful in selling our products through new distributors, the rate of growth of our revenue could be harmed if our existing distributors do not continue to sell a large dollar volume of our products. None of our existing distributors are obligated to continue selling our products.

We may be subject to foreign laws governing our relationships with our international distributors. These laws may require us to make payments to our distributors if we terminate our relationship for any reason, including for cause. Some countries require termination payments under local law or legislation that may supersede our contractual relationship with the distributor. Any required payments would adversely affect our operating results.

**If we lose our relationship with any supplier of key product components or our relationship with a supplier deteriorates or key components are not available in sufficient quantities, our manufacturing could be delayed and our business could suffer**

We contract with third parties for the supply of some of the components used in our products and the production of our disposable products. Some of our suppliers are not obligated to continue to supply us. We have relatively few sources of supply for some of the components used in our products and in some cases we rely entirely on sole-source suppliers. In addition, the lead-time involved in the manufacturing of some of these components can be lengthy and unpredictable. If our suppliers become unwilling or unable to supply us with components meeting our requirements, it might be difficult to establish additional or replacement suppliers in a timely manner, or at all. This would cause our product sales to be disrupted and our revenue and operating results to suffer.

Replacement or alternative sources might not be readily obtainable due to regulatory requirements and other factors applicable to our manufacturing operations. Incorporation of components from a new supplier into our products may require a new or supplemental filing with applicable regulatory authorities and clearance or approval of the filing before we could resume product sales. This process may take a substantial period of time, and we may not be able to obtain the necessary regulatory clearance or approval. This could create supply disruptions that would harm our product sales and operating results.

**We depend upon key employees in a competitive market for skilled personnel, and, without additional employees, we cannot grow or maintain profitability**

Our products and technologies are complex, and we depend substantially on the continued service of our senior management team. The loss of any of our key employees could adversely affect our business and slow our



---

**Table of Contents**

product development process. Our future success also will depend, in part, on the continued service of our key management personnel, software engineers, and other research and development employees, and our ability to identify, hire, and retain additional personnel, including customer service, marketing, and sales staff. Demand for these skilled employees in our industry is very competitive due to the limited number of people available with the necessary technical skills and understanding of our product technologies. We may be unable to attract and retain personnel necessary for the development of our business.

**Our ability to market and sell products depends upon receipt of domestic and foreign regulatory approval of our products and manufacturing operations. Our failure to obtain or maintain regulatory approvals and compliance could negatively affect our business**

Our products and manufacturing operations are subject to extensive regulation in the United States by the FDA and by similar regulatory agencies in other countries. Our products are classified as medical devices. Medical devices are subject to extensive regulation by the FDA pursuant to regulations that are wide ranging and govern, among other things: design and development; manufacturing and testing; labeling; storage and record keeping; advertising, promotion, marketing, sales distribution and export; and surveillance and reporting of deaths or serious injuries.

Unless an exemption applies, each medical device that we propose to market in the U.S. must first receive one of the following types of FDA premarket review authorizations:

Clearance via Section 510(k) of the Food, Drug, and Cosmetics Act of 1938, as amended; or

Premarket approval via Section 515 of the Food, Drug, and Cosmetics Act if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA will clear marketing of a medical device through the 510(k) process if it is demonstrated that the new product is substantially equivalent to other 510(k)-cleared products. The premarket approval application process is much more costly, lengthy and uncertain than the 510(k) process, and must be supported by extensive data from preclinical studies and human clinical trials. The FDA may not grant either 510(k) clearance or premarket approval for any product we propose to market. Further, any modification to a 510(k)-cleared device that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design or manufacture, requires a new 510(k) clearance or, possibly, approval of a premarket approval application. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review any manufacturer's decision. If the FDA requires us to seek 510(k) clearance or premarket approval for modification of a previously cleared product for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties. Further, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective.

Delays in receipt of, or failure to receive, clearances or approvals, the loss of previously received clearances or approvals, or the failure to comply with existing or future regulatory requirements could adversely impact our operating results. If the FDA finds that we have failed to comply with these requirements, the Agency can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as:

Fines, injunctions and civil penalties;

Recall or seizure of our products;

Issuance of public notices or warnings;

Imposition of operating restrictions, partial suspension, or total shutdown of production;

Refusal of our requests for Section 510(k) clearance or premarket approval of new products;

Withdrawal of Section 510(k) clearance or premarket approvals already granted; or

Criminal prosecution.

---

**Table of Contents**

Domestic regulation of our products and manufacturing operations, other than that which is administered by the FDA, includes the Environmental Protection Act, the Occupational Safety and Health Act, and state and local counterparts to these Acts.

**Our business would be harmed if the FDA determines that we have failed to comply with applicable regulations governing the manufacture of our products and/or we do not pass an inspection**

We and our suppliers are required to demonstrate and maintain compliance with the FDA's Quality System Regulation. The Quality System Regulation sets forth the FDA's requirements for good manufacturing practices of medical devices and includes requirements for, among other things, the design, testing, production processes, controls, quality assurance, labeling, packaging, storage and shipping of such products. In addition, we and our suppliers must engage in extensive recordkeeping and reporting and must make available our manufacturing facility and records for periodic unscheduled inspections by federal, state and foreign agencies, including the FDA. We cannot assure you that we and our suppliers are or will continue to be in full compliance with the Quality System Regulation, and that we will not encounter any manufacturing difficulties.

Failure of our third party suppliers and manufacturers or us to comply with applicable regulations could result in sanctions being imposed on us, including, among other things, fines, injunctions, civil penalties, failure of regulatory authorities to grant marketing approval of our products, delays, suspension or withdrawal of approvals, seizures or recalls of products and manufacturing restrictions, any of which could harm our business.

**Our Olympic Cool-Cap product is subject to greater products liability exposure and FDA regulation**

The FDA classifies medical devices into one of three classes depending on the degree of risk associated with each medical device and the extent of controls that are needed to ensure safety and effectiveness. Devices deemed to pose lower risk are placed in either Class I or Class II. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life supporting or implantable devices, or a device deemed to not be substantially equivalent to a previously cleared 510(k) device are placed in class III, and generally require premarket approval from the FDA before they may be marketed.

Our Olympic Cool-Cap is a Class III minimally invasive medical device, and as such we may be subject to an increased product liability risk relative to our other Class I and Class II non-invasive products. In addition, this type of product is subject to greater FDA oversight than our other products and there is greater risk that sales of the product could be interrupted due to the premarket approval processes of the FDA and other regulatory bodies.

**Our business may suffer if we are required to revise our labeling or promotional materials, or if the FDA takes an enforcement action against us for off-label uses**

We are prohibited by the FDA from promoting or advertising our medical device products for uses not within the scope of our clearances or approvals, or from making unsupported promotional claims about the benefits of our products. If the FDA determines that our claims are outside the scope of our clearances, or are unsupported, it could require us to revise our promotional claims or take enforcement action against us. If we were subject to such an action by the FDA, our sales could be delayed, our revenue could decline, and our reputation among clinicians could be harmed. Likewise, if we acquire new products, either through the purchase of products, technology assets, or businesses, that are subsequently deemed to have inadequate supporting data, we may be required to (i) obtain adequate data, which could be costly and impede our ability to market these products, or (ii) modify the labeling on these products, which could impair their marketability, as described above.

**If we deliver products with defects, we may incur costs to repair and, possibly, recall that product and market acceptance of our products may decrease.**

The manufacturing and marketing of our products involve an inherent risk of our delivering a defective product or products that do not otherwise perform as we expect. We may incur substantial expense to repair any

---

**Table of Contents**

such products and may determine to recall such a product, even if not required to do so under applicable regulations. Any such recall would be time consuming and expensive. Product defects or recalls may adversely affect our customers' acceptance of the recalled and other of our products. As an example, in the second quarter of 2010 we discontinued selling the Sonamed Clarity newborn hearing screening product line and incurred costs associated with sales concessions awarded customers who traded in a Clarity device for one of our existing newborn hearing screening devices and the write-down of inventory. We also recorded an impairment charge to write-off the carrying value of the Sonamed and Clarity tradenames.

**If we fail to comply with healthcare regulations, we could face substantial penalties and our business, operations and financial condition could be adversely affected.**

We do not provide healthcare services, control the referral of patients for healthcare services, nor bill Medicare, Medicaid or other third-party payors; however, due to the breadth of many healthcare laws and regulations, we could be subject to healthcare fraud regulation and enforcement by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include: (i) the federal healthcare programs Anti-Kickback Law, which prohibits, among other things, persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual for, or the purchase, order or recommendation of, any good or service for which payment may be made under federal healthcare programs such as Medicare or Medicaid, (ii) federal false claims laws which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payors that are false or fraudulent, and which may apply to entities like us which provide coding and billing advice to customers, and/or (iii) state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers, many of which differ from their federal counterparts in significant ways, thus complicating compliance efforts.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations. Any penalties, damages, fines, curtailment or restructuring of our operations could adversely affect our ability to operate our business and our financial results. The risk of our being found in violation of these laws is increased by the fact that their provisions are open to a variety of interpretations. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

**Our operating results would suffer if we were subject to a protracted infringement claim**

The medical technology industry is characterized by a substantial amount of litigation and related administrative proceedings regarding patents and intellectual property rights. We expect that medical screening and diagnostic products may become increasingly subject to third-party infringement claims as the number of competitors in our industry grows and the functionality of products overlap. Third parties such as individuals, educational institutions, or other medical device companies may claim that we infringe their intellectual property rights. Any claims, with or without merit, could have any of the following negative consequences:

Result in costly litigation and damage awards;

Divert our management's attention and resources;

Cause product shipment delays or suspensions; or

Require us to seek to enter into royalty or licensing agreements.

A successful claim of infringement against us could result in a substantial damage award and materially harm our financial condition. Our failure or inability to license the infringed or similar technology, or design and build non-infringing products, could prevent us from selling our products and adversely affect our business and financial results.



## **Table of Contents**

We may also find it necessary to bring infringement actions against third parties to seek to protect our intellectual property rights. Litigation of this nature, even if successful, is often expensive and disruptive of our management's attention, and in any event may not lead to a successful result relative to the resources dedicated to any such litigation.

### **We license intellectual property rights from third parties and would be adversely affected if our licensors do not appropriately defend their proprietary rights or if we breach any of the agreements under which we license commercialization rights to products or technology from others**

We license rights from third parties for products and technology that are important to our business. If our licensors are unsuccessful in asserting and defending their proprietary rights, including patent rights and trade secrets, we may lose the competitive advantages we have through selling products that we license from third parties. Additionally, if it is found that our licensors infringe on the proprietary rights of others, we may be prohibited from marketing our existing products that incorporate those proprietary rights. Under our licenses, we are subject to commercialization and development, sublicensing, royalty, insurance and other obligations. If we fail to comply with any of these requirements, or otherwise breach a license agreement, the licensor may have the right to terminate the license in whole or to terminate the exclusive nature of the license.

### **Product liability suits against us could result in expensive and time consuming litigation, payment of substantial damages, and an increase in our insurance rates**

The sale and use of our products could lead to the filing of a product liability claim by someone claiming to have been injured using one of our products or claiming that one of our products failed to perform properly. A product liability claim could result in substantial damages and be costly and time consuming to defend, either of which could materially harm our business reputation or financial condition. Our product liability insurance may not protect our assets from the financial impact of defending a product liability claim. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing any coverage in the future.

### **We have experienced seasonality in the sale of our products**

We experience seasonality in our revenue. For example, our sales typically decline from our fourth fiscal quarter to our first fiscal quarter, due to patterns in the capital budgeting and purchasing cycles of our customers, many of which are government agencies, and the compensation arrangements of our direct sales employees, as those arrangements are tied to calendar-year sales plans. We may also experience declining sales in the third fiscal quarter due to summer holiday and vacation schedules. We anticipate that we will continue to experience these seasonal fluctuations, which may lead to fluctuations in our quarterly operating results. We believe that you should not rely on our results of operations for interim periods as an indication of our expected results in any future period.

### **ITEM 1B. Unresolved Staff Comments.**

None.

### **ITEM 2. Properties**

Our corporate headquarters are located in San Carlos, California, in facilities covering 26,300 square feet pursuant to a lease that expires in June 2015.

We also utilize the following properties:

#### **Company-owned Facilities:**

44,900 square feet in Oakville, Ontario, Canada, utilized substantially for the operations of Xltek;

Edgar Filing: NATUS MEDICAL INC - Form 10-K

26,000 square feet in Mundelein, Illinois, utilized substantially for the operations of Bio-logic;

116,000 square feet in Buenos Aires, Argentina, utilized substantially for the operations of Medix.

**Table of Contents**

**Leased Facilities:**

65,000 square feet in Seattle, Washington, pursuant to a lease that expires in December 2011, that is utilized substantially for the operations of Olympic Medical;

12,000 square feet in Clackamas, Oregon, pursuant to a lease that expires in April, 2014, that is utilized substantially for the operations of Neurocom;

2,900 square feet in Hauppauge, New York, pursuant to a lease that expires in October 2012, that is utilized substantially for the operations of Neometrics;

48,000 square feet in Skovlunde, Denmark, pursuant to a lease that expires with six months notice that is utilized for the operations of Alpine Biomed;

29,000 square feet in Munich, Germany, pursuant to a lease that expires in March, 2012, that is utilized substantially for the operations of Schwarzer Neurology and Fischer-Zoth; and 1,700 square feet in Langenfeld, Germany, pursuant to a lease on a month to month basis, that is utilized substantially for the operations of Alpine Biomed Germany; and

3,250 square feet in Paris and 7,500 square feet in Bordeaux, both in France, pursuant to leases that expire in October 2019, and March 2012, respectively, that are utilized substantially for the operations of Deltamed.

**ITEM 3. Legal Proceedings**

We may from time to time become a party to various legal proceedings or claims that arise in the ordinary course of business. We are not currently involved in any legal or administrative proceedings that we believe are likely to have a materially adverse effect on our business, financial condition, or results of operations, although we cannot be assured of the outcome of such matters.

**ITEM 4. (Reserved)**



**Table of Contents****PART II****ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock trades on the Nasdaq Global Select Market under the symbol "BABY". The following table sets forth, for the periods indicated, the high and low sale price per share of our common stock, as reported on the Nasdaq Global Select Market.

	High	Low
Fiscal Year Ended December 31, 2010:		
Fourth Quarter	\$ 15.18	\$ 12.91
Third Quarter	16.58	11.75
Second Quarter	17.93	15.41
First Quarter	15.91	12.82
Fiscal Year Ended December 31, 2009:		
Fourth Quarter	\$ 16.22	\$ 12.59
Third Quarter	17.51	9.92
Second Quarter	11.72	7.08
First Quarter	13.00	6.46

As of March 7, 2011, there were 28,974,250 shares of our common stock issued and outstanding and held by approximately 41 stockholders of record. We estimate that there are approximately 11,000 beneficial owners of our common stock.

**Dividends**

We have never declared or paid cash dividends on our capital stock. We currently expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Based on the terms of our Amended and Restated Credit Agreement with Wells Fargo Bank, National Association, we are prevented from paying dividends without the prior approval of the bank.

**Table of Contents****Stock Performance Graph**

The following information of Part II Item 5 is being furnished and shall not be deemed to be soliciting material or to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section, nor will it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate such information by reference thereto.

The following graph shows a comparison, from January 1, 2005 through December 31, 2010, of cumulative total return for our common stock, the Nasdaq Composite Index and the Standard & Poor's 500 Health Care Equipment Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Standard & Poor's 500 Health Care Equipment Index assumes reinvestment of dividends.

		2005	2006	2007	2008	2009	2010
Natus Medical Inc.	Return %		2.91	16.49	(33.08)	14.21	(4.12)
	Cum \$	\$100.00	102.91	119.88	80.23	91.63	87.85
NASDAQ Composite-Total Returns	Return %		10.39	10.65	(39.98)	45.36	18.16
	Cum \$	\$100.00	110.39	122.15	73.32	106.58	125.93
S&P 500 Health Care Equipment Index	Return %		4.11	5.15	(27.63)	28.75	(2.70)
	Cum \$	\$100.00	104.11	109.47	79.22	102.00	99.24

**ITEM 6. Selected Financial Data**

The following tables set forth certain selected consolidated financial data as of December 31, 2010, 2009, 2008, 2007 and 2006 and for each of the years in the five-year period ended December 31, 2010, and is derived from the consolidated financial statements of Natus Medical Incorporated and its subsidiaries. The consolidated financial statements as of December 31, 2010 and 2009 and for each of the years in the three-year period ended December 31, 2010 are included elsewhere in this report. The selected consolidated balance sheet data as of December 31, 2008, 2007 and 2006 and the consolidated statements of operations data for the years ended December 31, 2007 and 2006 are derived from our consolidated financial statements, which are not included in this report. The selected consolidated financial data set forth below is qualified in its entirety by, and should be

**Table of Contents**

read in conjunction with, the Consolidated Financial Statements and Notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report.

	2010	2009	Year ended December 31,		2006
			2008	2007	
	(in thousands, except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Revenue	\$ 218,655	\$ 166,425	\$ 161,831	\$ 118,269	\$ 89,915
Cost of Revenue	88,698	66,077	61,332	42,704	33,665
Gross profit	129,957	100,348	100,499	75,565	56,250
Operating expenses:					
Marketing and selling	54,857	45,304	39,998	28,024	21,944
Research and development	21,283	16,732	15,520	15,645	10,604
General and administrative	35,986	22,979	19,808	15,214	11,004
Acquired in-process research and development				300	9,800
Total operating expense	112,126	85,015	75,326	59,183	53,352
Income from operations	17,831	15,333	25,173	16,382	2,898
Other income (expense), net	(118)	1,750	2,142	101	225
Income before provision for income taxes	17,713	17,083	27,315	16,483	3,123
Provision for income tax expense	5,794	5,701	10,033	6,417	4,050
Net income (loss)	\$ 11,919	\$ 11,382	\$ 17,282	\$ 10,066	\$ (927)
Earnings (loss) per share:					
Basic	\$ 0.42	\$ 0.41	\$ 0.68	\$ 0.47	\$ (0.05)
Diluted	\$ 0.41	\$ 0.40	\$ 0.65	\$ 0.44	\$ (0.05)
Weighted average shares used in the calculation of earnings (loss) per share:					
Basic	28,092	27,651	25,278	21,600	19,548
Diluted	29,217	28,476	26,557	22,815	19,548
	2010	2009	December 31,		2006
			2008	2007	
	(in thousands)				
<b>Balance Sheet Data:</b>					
Cash, cash equivalents, and short-term investments	\$ 29,388	\$ 33,551	\$ 56,915	\$ 11,916	\$ 15,392
Working capital	83,922	75,207	97,593	19,448	30,803
Total assets	331,047	292,090	258,158	190,353	124,163
Long-term debt (including current portion)	893	1,109	1,288	36,816	
Total stockholders' equity	263,255	243,557	226,312	116,007	101,026

Results of operations and financial position of the business we have acquired are included from their acquisition dates as follows: Bio-logic in January 2006, Deltamed in September 2006, Olympic in October 2006, Xltek in November 2007, Sonamed in May 2008, Schwarzer Neurology in July 2008, Neurocom in October 2008, Hawaii Medical in July 2009, Alpine Biomed in September 2009, and Medix in October 2010.

Acquired in-process research and development charges in 2007 are associated with our acquisition of Xltek, and in 2006 with our acquisitions of Bio-logic and Olympic.

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

The selected financial data gives effect to the corrections discussed in Note 20, Immaterial Corrections to Prior Period Financial Statements in the Notes to Consolidated Financial Statements of our Consolidated Financial Statements contained herein.

## **Table of Contents**

### **ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with our financial statements and the accompanying footnotes. MD&A includes the following sections:

**Our Business.** A general description of our business.

**Year 2010 Overview.** A summary of key information concerning the financial results for 2010 and changes from 2009.

**Application of Critical Accounting Policies.** A discussion of the accounting policies that are most important to the portrayal of our financial condition and results of operations and that require critical judgments and estimates.

**Results of Operations.** An analysis of our results of operations for the three years presented in the financial statements.

**Liquidity and Capital Resources.** An analysis of capital resources, sources and uses of cash, investing and financing activities, and contractual obligations.

**Quantitative and Qualitative Disclosures about Market Risk.** A summary of currency exchange issues and interest rate hedging.

**Off-Balance Sheet Arrangements.** An analysis of off-balance sheet arrangements.

**Recent Accounting Pronouncements.** A recap of recently issued accounting pronouncements that may have an impact on our results of operations, financial position or cash flows.

**Cautionary Information Regarding Forward-Looking Statements.** Cautionary information about forward-looking statements.

### **Business**

Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, incubators to control the newborn's environment, and software systems for managing and tracking disorders and diseases for public health laboratories.

We have completed a number of acquisitions since 2003, consisting of either the purchase of a company, substantially all of the assets of a company, or individual products or product lines. Our significant acquisitions are as follows: Neometrics in 2003, Fischer-Zoth in 2004, Bio-logic, Deltamed, and Olympic in 2006, Xltek in 2007, Sonamed, Schwarzer Neurology, and Neurocom in 2008, Hawaii Medical and Alpine Biomed in 2009, and Medix in 2010.

### **Year 2010 Overview**

We faced an uncertain business in 2010 as the global economy continued its recovery from the recessionary economic conditions that existed in many parts of the world during 2008 and 2009, particularly in North America and Europe where we conduct the majority of our business.

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

Our consolidated revenue increased \$52.2 million for the year ended December 31, 2010 compared to 2009, primarily as a result of improved economic conditions. Revenue increased across all of our business units. Alpine Biomed and Hawaii Medical, that we acquired in 2009, contributed to \$22.7 of incremental revenue in 2010, while Medix, that was acquired in 2010, contributed to \$7.1 of revenue in 2010.

## **Table of Contents**

During the second fiscal quarter of 2010 we substantially completed the reorganization plan adopted in January 2010 that was designed to eliminate redundant costs resulting from our acquisition of Alpine Biomed and to improve efficiencies in operations. Under the plan, Alpine operations in Montreal, Canada were transitioned to our existing Xltek facility in Oakville, Ontario, Canada. Alpine's sales organization was merged into the Company's global sales organization during the first fiscal quarter of 2010.

Also in the second fiscal quarter of 2010 we discontinued the Sonamed Clarity hearing screening product line and began converting users to our other newborn hearing screening products. This action resulted in a non-recurring charge totaling \$1.4 million that reduced reported gross profit by \$1.1 million or 0.8 percentage points and increased operating expenses by \$300,000. The conversion was substantially complete as of December 31, 2010.

During the third quarter of 2010 we received a purchase order from the Kingdom of Saudi Arabia for our newborn care products. The order, valued at over \$2.9 million, was for our ALGO newborn hearing screeners, Cool-Cap selective head-cooling devices, Olympic Cerebral Functions Monitors (CFM), and associated disposable supplies. We completed the shipment of this purchase order in the fourth quarter.

We acquired Medix in October 2010 for \$14.1 million in cash. Medix, based in Buenos Aires, Argentina, manufactures incubators for use in hospital nurseries and NICU's, transport incubators for use in ambulances and other emergency vehicles, infant warmers, and LED-based phototherapy devices.

We do not believe that our markets have yet returned to the level of activity that prevailed prior to the commencement of the credit crisis in the third quarter of 2008 that precipitated the global economic crisis. As a result of cost containment and other measures we have implemented, and our recent acquisitions, we believe that we continue to be well-positioned to capitalize on improving market conditions as, and to the extent, that such conditions develop.

### **Application of Critical Accounting Policies**

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America ( GAAP ). In so doing, we must often make estimates and use assumptions that can be subjective and, consequently, our actual results could differ from those estimates. For any given individual estimate or assumption we make, there may also be other estimates or assumptions that are reasonable.

We believe that the following critical accounting policies require the use of significant estimates, assumptions, and judgments. The use of different estimates, assumptions, and judgments could have a material effect on the reported amounts of assets, liabilities, revenue, expenses, and related disclosures as of the date of the financial statements and during the reporting period.

#### ***Revenue recognition***

Revenue, net of discounts, is recognized from sales of medical devices and supplies, including sales to distributors, when the following conditions have been met: a purchase order has been received, title has transferred, the selling price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Terms of sale for most domestic sales are FOB origin, reflecting that title and risk of loss are assumed by the purchaser at the shipping point; however, terms of sale for some neurology, sleep-diagnostic, and head cooling systems are FOB destination, reflecting that title and risk of loss are assumed by the purchaser upon delivery. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped ex works, in which title and risk of loss are assumed by the distributor at the shipping point.

We have historically applied the software revenue recognition rules as prescribed by Accounting Standards Codification ( ASC ) Subtopic 985-605 to sales of certain of our diagnostic neurology and hearing systems ( products containing embedded software ). In October 2009, the Financial Accounting Standards Board

---

**Table of Contents**

( FASB ) issued Accounting Standards Update No. ( ASU ) 2009-14, *Certain Revenue Arrangements That Include Software Elements*, which amended ASC Subtopic 985-605, and we prospectively adopted the provisions of ASU 2009-14 on January 1, 2010. This ASU removes tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of the software revenue recognition rules. In the case of the Company's products containing embedded software, we have determined that the hardware and software components function together to deliver the product's essential functionality, and therefore, the revenue from the sale of these products no longer falls within the scope of the software revenue recognition rules. Our revenue recognition policies for sales of these products are now substantially the same as for our other tangible products.

Revenue from sales of certain of our products that remain within the scope of the software revenue recognition rules under ASC Subtopic 985-605 is not significant.

We previously accounted for arrangements with multiple deliverables under ASC Topic 605, where revenue was allocated to the deliverables based on vendor specific objective evidence ( VSOE ). In October 2009 the FASB issued ASU 2009-13, *Multiple Deliverable Revenue Arrangements*, which amends ASC Topic 605, and we prospectively adopted the provisions of ASU 2009-13 on January 1, 2010. Under the revenue recognition rules for tangible products as amended by ASU 2009-13, we now allocate revenue from arrangements with multiple deliverables to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. The principal deliverables in our multiple deliverable arrangements that qualify as separate units of accounting consist of (i) sales of medical devices and supplies, (ii) installation services, (iii) extended service and maintenance agreements, and (iv) upgrades to embedded software.

The new rules establish a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value ( VSOE ), (ii) third-party evidence of selling price ( TPE ), and (iii) best estimate of the selling price ( ESP ). VSOE of fair value is defined as the price charged when the same element is sold separately, or if the element has not yet been sold separately, the price for the element established by management having the relevant authority when it is probable that the price will not change before the introduction of the element into the marketplace. VSOE generally exists only when we sell the deliverable separately and is the price actually charged for that deliverable. We have previously established VSOE for substantially all of the deliverables in our multiple element arrangements; however, in the future we may rely on ESPs, reflecting our best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis, to establish the amount of revenue to allocate to the deliverable. TPE generally does not exist for our products because of their uniqueness.

For products shipped under FOB origin or EXW terms, delivery is generally considered to have occurred when shipped. Undelivered elements in our sales arrangements, which are not considered to be essential to the functionality of a product, generally include installation or training services that are performed after the related products have been delivered. Revenue related to undelivered installation services is deferred until such time as installation is complete at the customer's site. Revenue related to training services is recognized when the service is provided. Fair value for installation or training services is based on the price charged when the service is sold separately. The fair value of installation and training services is based upon billable hourly rates and the estimated time to complete the service.

Revenue from extended service and maintenance agreements, for both medical devices and data management systems, is recognized ratably over the service period. Freight charges billed to customers are included in revenue and freight-related expenses are charged to cost of revenue. Advance payments from customers are recorded as deferred revenue and recognized as revenue as otherwise described above. We generally do not provide rights of return on products. We accept trade-ins of our own and competitive medical devices. Trade-ins are recorded as a reduction of the replacement medical device sale. Provisions are made for initial standard warranty obligations that are generally one year in length.



---

**Table of Contents**

***Inventory is carried at the lower of cost or market value***

We may be exposed to a number of factors that could result in portions of our inventory becoming either obsolete or being held in quantities that exceed anticipated usage. These factors include, but are not limited to: technological changes in our markets, competitive pressures in products and prices, and our own introduction of new product lines.

We regularly evaluate our ability to realize the value of our inventory based on a combination of factors, including historical usage rates, forecasted sales, product life cycles, and market acceptance of new products. When we identify inventory that is obsolete or in excess of anticipated usage we write it down to realizable salvage value. The estimates we use in projecting future product demand may prove to be incorrect. Any future determination that our inventory is overvalued could result in increases to our cost of sales and decreases to our operating margins and results of operations.

***Carrying value of intangible assets and goodwill***

We amortize intangible assets with finite lives over their useful lives; any future changes that would limit their useful lives or any determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges. We carry goodwill and any other intangible assets with indefinite lives at original cost but do not amortize them. Any future determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges, which could significantly impact our operating results.

We test our definite-lived intangible assets for impairment whenever changes in circumstances indicate the carrying value of these assets may be impaired. Impairment indicators include, but are not limited to, net book value as compared to market capitalization, significant negative industry and economic trends, and significant underperformance relative to historical and projected future operating results. Impairment is considered to have occurred when the estimated undiscounted future cash flows related to the asset are less than its carrying value. Estimates of future cash flows involve consideration of many factors including the marketability of new products, product acceptance and lifecycle, competition, appropriate discount rates, and operating margins.

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually as of October 1st; this assessment is also performed whenever there is a change in circumstances that indicates the carrying value of these assets may be impaired. The determination of whether any potential impairment of goodwill exists is based upon a two step process. In the first analysis, the fair value of the reporting unit is compared to the unit's fair value, including goodwill, to determine if there is a potential impairment. If the fair value exceeds the carrying amount, the goodwill of the reporting unit is considered not impaired and no further analysis or action is required. If the first analysis indicates that the carrying value exceeds the fair value, a second analysis is performed to determine the amount of the goodwill impairment loss, if any.

In step two of the impairment test, the implied fair value of a reporting unit's goodwill is compared to the carrying amount of that goodwill. The implied fair value of the goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, the entity shall allocate the fair value of a reporting unit to all the assets and liabilities of that reporting unit, including unrecognized intangible assets as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of that goodwill.

To determine the estimated fair value of reporting units, three valuation methodologies are utilized: (i) discounted cash flow analyses, (ii) market multiples, and (iii) comparative transactions. The valuations indicated by these three methodologies are averaged, with the greatest weight placed on discounted cash flow analyses. Discounted cash flow analyses are dependent upon a number of quantitative and qualitative factors including estimates of forecasted revenue, profitability, earnings before interest, taxes, depreciation and amortization (i.e. EBITDA) and terminal values. The discount rates applied in the discounted cash flow analyses also have an impact on the estimates of fair value, as use of a higher rate will result in a lower estimate of fair value. The estimated total fair value of reporting units is reconciled to the Company's market capitalization.

**Table of Contents*****Liability for product warranties***

Our medical device products are covered by standard one-year product warranty plans. A liability has been established for the expected cost of servicing our medical device products during these service periods. We base the liability on actual warranty costs incurred to service those products. On new products, additions to the reserve are based on a combination of factors including the percentage of service department labor applied to warranty repairs, as well as actual service department costs and other judgments, such as the degree to which the product incorporates new technology applied to the number of units sold. As warranty costs are incurred, the reserve is reduced.

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

***Share-based compensation***

We record the fair value of share-based compensation awards as expenses in the consolidated statement of operations. In order to determine the fair value of stock options on the date of grant, we apply the Black-Scholes option-pricing model. Inherent in this model are assumptions related to expected dividend yield, risk-free interest rate, expected stock-price volatility, expected term, and forfeiture rate. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, expected stock-price volatility, expected life, and forfeiture rate assumptions require a greater level of judgment which makes them critical accounting estimates. If we used different assumptions, we would have recorded different amounts of share-based compensation.

**Results of Operations**

The discussion to follow gives effect to the correction of errors detailed in Note 20, *Immaterial Corrections to Prior Period Financial Statements* in the *Notes to Consolidated Financial Statements* of our Consolidated Financial Statements contained herein.

The following table sets forth for the periods indicated selected consolidated statement of operations data as a percentage of total revenue. Our historical operating results are not necessarily indicative of the results for any future period.

	<b>Percent of Revenue</b>		
	<b>Years Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
Revenue	100.0 %	100.0 %	100.0 %
Cost of revenue	40.6	39.7	37.9
Gross profit	59.4	60.3	62.1
Operating expenses:			
Marketing and selling	25.1	27.2	24.7
Research and development	9.7	10.0	9.6
General and administrative	16.5	13.8	12.2
Total operating expenses	51.3	51.0	46.5
Income from operations	8.1	9.3	15.6
Other income (expense), net	(0.1)	1.0	1.3
Income before provision for income tax	8.0	10.3	16.9
Income tax provision	2.6	3.4	6.2
Net income	5.4%	6.9%	10.7%



## **Table of Contents**

### **Acquisitions**

We completed six significant acquisitions during 2010, 2009 and 2008, and the timing of these acquisitions had an impact on the comparison of our results of operations for the years ended December 31, 2010, 2009 and 2008.

**Medix** Completed on October 12, 2010. Medix reported revenue of approximately \$25.2 million during its last completed fiscal year prior to the acquisition.

**Alpine Biomed** Completed on September 14, 2009. Alpine Biomed reported revenue from its neurology business of approximately \$38.1 million during its last completed fiscal year prior to the acquisition.

**Hawaii Medical** Completed on July 2, 2009. Hawaii Medical reported revenue of approximately \$3.2 million during its last completed fiscal year prior to the acquisition.

**Neurocom** Completed on October 2, 2008. Neurocom reported revenue of approximately \$11.4 million during its last completed fiscal year prior to the acquisition.

**Schwarzer Neurology** Completed on July 2, 2008. Schwarzer Neurology reported revenue of approximately \$7.1 million during its last completed fiscal year prior to the acquisition.

**Sonamed** Completed on May 27, 2008. Sonamed reported revenue of approximately \$3.5 million during its last completed fiscal year prior to the acquisition.

The pre-acquisition revenue of our acquired companies may not be indicative of their contribution to revenue in the future.

### ***Comparison of 2010 and 2009***

#### ***Operating Results***

Because our acquisitions have been significant, we measure the contribution to consolidated revenue of the businesses we acquire. We also analyze our revenue as coming from two sources: devices and systems, and supplies and services. We report freight revenue separate from these two sources.

Our consolidated revenue increased \$52.2 million for the year ended December 31, 2010 compared to 2009, primarily as a result of improved economic conditions. Revenue increased across all of our business units. The companies that were acquired in 2009, Alpine Biomed and Hawaii Medical, contributed to \$22.7 of incremental revenue in 2010, while Medix, that was acquired in 2010, contributed to \$7.1 million of revenue in 2010. Revenue from our hearing products increased \$3.4 million, while revenue from our existing neurology and newborn care products increased by \$19.0 million.

Revenue from devices and systems was \$134.8 million in 2010, representing an increase of 40% or \$38.6 million, from \$96.2 million reported in 2009. Alpine Biomed contributed to \$13.0 million of incremental devices and systems revenue in 2010, while Medix contributed to \$4.1 million of devices and systems revenue in 2010. Revenue from our hearing products increased \$5.1 million, to \$30.3 million, while revenue from our existing neurology and newborn care products increased by \$17.8 million to \$62.1 million, offset by a \$1.4 million decrease in balance monitoring products.

Revenue from supplies and services was \$80.3 million in 2010, representing an increase of 20%, or \$13.2 million from \$67.1 million in 2009. Alpine Biomed, Medix and Hawaii Medical contributed to \$6.8 million, \$3.0 million and \$2.7 million, respectively, of incremental revenue from supplies and services. Supplies and service revenue from our existing products increased by \$700,000 to \$67.8 million.

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

Revenue from devices and systems was 62% of consolidated revenue in 2010 compared to 58% of total revenue in 2009, and revenue from supplies and services was 37% of total revenue in 2010 compared to 40% of revenue in 2009. Freight revenue of \$3.6 million in 2010 and \$3.2 million in 2009 represented 1% and 2% of total revenue in 2010 and 2009, respectively.

---

**Table of Contents**

No customer accounted for more than 10% of our revenue in either 2010 or 2009. Revenue from domestic sales increased 15% to \$126.9 million in 2010, from \$109.7 million in 2009. Revenue from international sales increased 62% to \$91.8 million in 2010, compared to \$56.8 million in 2009. Revenue from domestic sales was 58% of total revenue in 2010, compared to 66% in 2009, and revenue from international sales was 42% of total revenue in 2010 compared to 34% of revenue in 2009. The changes in the percentages from 2010 to 2009 resulted primarily from the contribution of Alpine Biomed and Medix, whose sales are primarily in Europe and South America and related international markets, respectively.

Our cost of revenue increased \$22.6 million, or 34%, to \$88.7 million in 2010, from \$66.1 million in 2009. The increase was due mainly to our increased sales. In addition, our discontinuance of the Sonamed Clarity hearing screening line resulted in a non-recurring charge totaling \$1.1 million or 1.2% to our cost of revenue. Gross profit increased \$29.6 million, or 30%, to \$130.0 million in 2010 from \$100.3 million in 2009. Gross profit as a percentage of revenue was 59% in 2010 compared with 60% in 2009.

Total operating costs increased \$27.1 million, or 32%, to \$112.1 million in 2010, from \$85.0 million in 2009. The operations of Alpine Biomed and Medix contributed to \$11.7 million of the increase in operating costs. We also recorded a restructuring charge of \$3.1 million and other severance related costs of \$842,000 for which there was no comparable cost in 2009. The remainder of the increase in operating costs was proportionate to our increased sales as our operating costs as a percentage of revenue was 51% in 2010 and 2009.

Our marketing and selling expenses increased \$9.6 million, or 21%, to \$54.9 million in 2010, from \$45.3 million in 2009. The operations of Alpine Biomed and Medix contributed to \$5.0 million of the increase and the remainder of the increase was primarily related to higher sales commission and sales related costs associated with the increase in our revenue. Marketing and selling expenses as a percent of total revenue decreased to 25.1 % in 2010 from 27.2% in 2009.

Our research and development expenses increased \$4.6 million, or 27%, to \$21.3 million in 2010 from \$16.7 million in 2009. The operations of Alpine Biomed and Medix contributed to \$3.1 million of research and development expense. Research and development expenses as a percent of total revenue decreased to 9.7% in 2010 from 10.0% in 2009.

Our general and administrative expenses increased \$13.0 million, or 57%, to \$36.0 million in 2009 from \$23.0 million in 2009. General and administrative expenses as a percent of revenue increased from 13.8% in 2009 to 16.5% in 2010. \$3.5 million of the increase in general and administrative expenses was attributable to the operations of Alpine Biomed and Medix. We recorded a restructuring charge of \$3.1 million and other severance related costs of \$842,000 for which there were no comparable costs in 2009. Other expenses exclusive of those associated with Alpine Biomed, Medix, restructuring and severance related costs were \$5.6 million higher in 2010 compared to 2009, which resulted primarily from increased payroll and related benefit costs, professional fees, travel and outside consulting costs.

Other income (expense), net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income (expense), net of \$(118,000) in 2010, compared to \$1.7 million in 2009. Investment income of \$36,000 in 2010 was \$192,000 less than the amount reported for 2009 reflecting lower interest rates. We reported \$521,000 of foreign currency exchange losses in 2010 versus \$520,000 of foreign exchange gains in 2009. Interest expense was marginally lower in 2010 compared to 2009 due primarily to lower outstanding balances on our credit facilities.

We recorded income tax expense of \$5.8 million in 2010, compared to \$5.7 million recorded in 2009. Our effective tax rate for 2010 decreased to 32.7 % from 33.4% in 2009 because more of our income was taxed in foreign jurisdictions with tax rates lower than in the U.S. At December 31, 2010, we had federal net operating loss carryforwards of approximately \$4.6 million available to offset future taxable income. Income tax expense related to our international operations is based on the statutory rates in those jurisdictions.

---

**Table of Contents*****Comparison of 2009 and 2008******Operating Results***

Our revenue increased 3%, or \$4.6 million, to \$166.4 million in 2009, from \$161.8 million in 2008. Alpine Biomed, Neurocom and Schwarzer Neurology contributed \$17.4 million to this increase in our revenue in 2009. This was offset by a \$12.2 million net decrease in equipment sales across the Company's other product lines, resulting from a weakness in demand that we believe was due to the economic recession during 2009.

Revenue from devices and systems was \$96.2 million in 2009, representing a decrease of 6% or \$6.3 million, from \$102.5 million reported in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to \$12.1 million of the increase in revenue from devices and systems offset by a \$6.8 million decrease in hearing revenue, a \$5.3 million decrease in neurology revenue, and a \$3.1 million decrease in newborn care revenue. Revenue from supplies and services was \$67.1 million in 2009, representing an increase of 18%, or \$10.4 million, from \$56.7 million in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to \$5.1 million of the increase. Hearing supplies increased by \$1.3 million and newborn care supplies increased by \$2.0 million.

Revenue from devices and systems was 58% of consolidated revenue in 2009 compared to 63% of total revenue in 2008, and revenue from supplies and services was 40% of total revenue in 2009 compared to 35% of revenue in 2008. Freight revenue of \$3.2 million in 2009 and \$2.7 million in 2008 represented 2% of total revenue in both periods.

No customer accounted for more than 10% of our revenue in either 2009 or 2008. Revenue from domestic sales decreased 3% to \$109.7 million in 2009, from \$112.6 million in 2008. Revenue from international sales increased 15% to \$56.8 million in 2009, compared to \$49.2 million in 2008. Revenue from domestic sales was 66% of total revenue in 2009, compared to 70% in 2008, and revenue from international sales was 34% of total revenue in 2009 compared to 30% of revenue in 2008. The changes in the percentages from 2009 to 2008 resulted primarily from the contribution of Alpine Biomed, whose sales are primarily in Europe.

Our cost of revenue increased \$4.7 million, or 8%, to \$66.1 million in 2009, from \$61.3 million in 2008. The increase was primarily due to our increased sales and higher materials costs. Gross profit decreased \$151,000, or less than half a percent to \$100.3 million in 2009 from \$100.5 million in 2008. Gross profit as a percentage of revenue was 60% in 2009 compared to 62% in 2008. The decline in gross profit as a percentage of sales was due in part to the Alpine Biomed products having a lower gross margin than our existing products. In addition, the gross profit percentage of our European operations, excluding Alpine, was approximately 50% for 2009 compared to approximately 59% for 2008, due primarily to the impact that a lower revenue base had on manufacturing overhead as a percentage of revenue, as this cost is largely fixed.

Total operating costs increased \$9.7 million, or 13%, to \$85.0 million in 2009, from \$75.3 million in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to \$12.5 million of the increase in operating costs partially offset by a \$2.8 million decrease in operating costs in our North American divisions resulting from restructuring activities initiated in early 2008 that were substantially completed in that year. Our operating costs increased as a percentage of revenue from 47% in 2008 to 51% in 2009.

Our marketing and selling expenses increased \$5.3 million, or 13%, to \$45.3 million in 2009, from \$40.0 million in 2008. The operations of Alpine Biomed, Neurocom, and Schwarzer Neurology contributed to \$6.7 million of the increase offset by a decrease of \$1.2 million in sales compensation costs resulting from decreased direct sales of devices. Marketing and selling expenses as a percent of total revenue increased from 24.7% in 2008 to 27.2% in 2009.

Our research and development expenses increased \$1.2 million, or 8%, to \$16.7 million in 2009 from \$15.5 million in 2008. The operations of Alpine Biomed, Neurocom, and Schwarzer Neurology contributed to

---

## **Table of Contents**

\$2.2 million of research and development expense, partially offset by reduced costs resulting from restructuring activities implemented in February 2008 for which we did not receive a benefit until late in 2008 and continuing into 2009. Research and development expenses as a percent of total revenue increased from 9.6% in 2008 to 10.0% in 2009.

Our general and administrative expenses increased \$3.2 million, or 16%, to \$23.0 million in 2009 from \$19.8 million in 2008. General and administrative expenses as a percent of revenue increased from 12.2% in 2008 to 13.8% in 2009. General and administrative expenses of Alpine Biomed, Neurocom and Schwarzer Neurology represented \$3.6 million of the increase. Direct costs of acquisitions completed in 2009 totaled \$460,000 and were reported as a component of general and administrative expense; we had no similar costs in 2008 under prior accounting rules. General and administrative expenses other than those mentioned above were approximately \$560,000 lower in 2009 compared to 2008.

Other income, net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income, net of \$1.7 million in 2009, compared to \$2.1 million in 2008. Investment income of \$228,000 in 2009 was \$801,000 less than the amount reported for 2008 reflecting lower interest rates and a lower investment portfolio due to our recent acquisitions. Net foreign currency exchange gains reported in 2009 were \$1.1 million less than the amount reported for 2008. We reported \$582,000 less in interest expense in 2009 compared to 2008 due primarily to lower outstanding balances on our credit facilities. In 2009 we also recorded a \$650,000 adjustment to the value of a contingent liability associated with the acquisition of Alpine Biomed that resulted in an increase to other income for which there was no similar item in 2008.

We recorded income tax expense of \$5.7 million in 2009, compared to \$10.0 million recorded in 2008. Our effective tax rate for 2009 decreased to 33.4% compared to 36.7% in 2008 because more of our income was taxed in foreign jurisdictions with tax rates lower than in the U.S. At December 31, 2009, we had federal net operating loss carryforwards of approximately \$8.2 million available to offset future taxable income. Income tax expense related to our international operations is based on the statutory rates in those jurisdictions.

## **Liquidity and Capital Resources**

### ***Comparison of 2010 and 2009***

Liquidity is our ability to generate sufficient cash flows from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate financing and to raise capital. Therefore, liquidity cannot be considered separately from capital resources that consist of our current funds and the potential to increase those funds in the future. We plan to use these resources in meeting our commitments and in achieving our business objectives.

As of December 31, 2010, we had cash, cash equivalents, and short-term investments of \$29.4 million, stockholders' equity of \$263.3 million, and working capital of \$83.9 million, compared with cash and cash equivalents of \$33.6 million, stockholders' equity of \$243.6 million, and working capital of \$75.2 million as of December 31, 2009.

We believe that our current cash and cash equivalents and any cash generated from operations will be sufficient to meet our ongoing operating and capital requirements for the foreseeable future. We completed the acquisition of Medix at the beginning of the fourth quarter of 2010, two acquisitions in 2009, four acquisitions in 2008, one in 2007, and three in 2006. We intend to continue to acquire additional technologies, products, or businesses and these acquisitions could be significant. These actions would likely affect our future capital requirements and the adequacy of our available funds. In order to finance future acquisitions, we may be required to raise additional funds through public or private financings, strategic relationships or other arrangements. Any equity financing may be dilutive to stockholders and debt financing, if available, may involve restrictive covenants and increase our cost of capital.



---

**Table of Contents**

We have a \$50 million revolving credit facility with Wells Fargo Bank, National Association ( Wells Fargo ). The revolving credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in substantially all of our assets. We did not draw on the facility during 2010. We have no other significant credit facilities.

Global capital markets have been, and may continue to be, disrupted and volatile. The cost and availability of equity and debt funding has been and may continue to be adversely affected by illiquid capital and credit markets. Some lenders have reduced or, in some cases, ceased to provide funding to borrowers. We believe that we have adequate liquidity to meet our present needs. Continued turbulence in the United States and international financial markets, however, could adversely affect the cost and availability of financing to us in the future and limit our ability to acquire products, other assets, or businesses.

Cash provided by operations decreased by \$15.0 million for the year ended December 31, 2010 to \$11.5 million, compared to \$26.6 million in 2009. The sum of our net income and certain non-cash expense items, such as reserves, depreciation and amortization, and share based compensation was approximately \$27.6 million in 2010, compared to \$24.7 million in 2009. The aggregate impact of changes in certain operating assets and liabilities was a cash outflow of \$16.1 million in 2010 compared to a cash inflow of \$1.9 million in 2009, in particular accounts receivable, inventories and accounts payable.

Cash used in investing activities was \$17.9 million for the year ended December 31, 2010, compared to \$51.8 million in 2009. We used \$4.2 million and \$2.6 million of cash to acquire property and equipment, during the years ended December 31, 2010 and 2009, respectively. We used \$13.4 million of cash to acquire businesses during the year ended December 31, 2010 compared with \$47.2 million during the year ended December 31, 2009. During the year ended December 31, 2010 we capitalized \$344,000 of internal use software development costs compared with \$1.0 million in 2009. In addition, we purchased and sold \$975,000 of marketable securities in 2010 and purchased \$965,000 of marketable securities during the year ended December 31, 2009.

Cash provided by financing activities was \$1.7 million in the year ended December 31, 2010, compared to \$489,000 in 2009. We received cash from sales of our stock pursuant to our stock awards plans and our employee stock purchase plan in the amount of \$2.5 million and \$1.1 million in the year ended December 31, 2010 and 2009, respectively. In 2010, we realized an excess tax benefit of \$551,000 on the exercise of employee stock options that was recorded as an increase to stockholders' equity. In 2009 our after-tax cost of stock-based compensation was \$159,000 more than the tax benefit we received from those arrangements which was recorded as a decrease to stockholders' equity. We repaid \$1.4 million and \$429,000 under term loan agreements in the years ended December 31, 2010 and 2009, respectively.

***Comparison of 2009 and 2008***

As of December 31, 2009, we had cash, cash equivalents, and short-term investments of \$33.5 million, stockholders' equity of \$243.6 million, and working capital of \$75.2 million, compared with cash and cash equivalents of \$56.9 million, stockholders' equity of \$226.4 million, and working capital of \$97.6 million as of December 31, 2008.

We believe that our current cash and cash equivalents and any cash generated from operations will be sufficient to meet our ongoing operating and capital requirements for the foreseeable future. We completed two acquisitions in 2009 including Alpine Biomed at the end of the third quarter, four acquisitions in 2008, one in 2007, and three in 2006. We intend to continue to acquire additional technologies, products, or businesses and these acquisitions could be significant. These actions would likely affect our future capital requirements and the adequacy of our available funds. In order to finance future acquisitions, we may be required to raise additional funds through public or private financings, strategic relationships or other arrangements. Any equity financing

---

**Table of Contents**

may be dilutive to stockholders and debt financing, if available, may involve restrictive covenants and increase our cost of capital.

We have a \$25 million revolving credit facility with Wells Fargo Bank, National Association ( Wells Fargo ). The revolving credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in all of our assets. We did not draw on the facility during 2009. We have no other significant credit facilities.

Global capital markets have been, and may continue to be, disrupted and volatile. The cost and availability of equity and debt funding has been and may continue to be adversely affected by illiquid capital and credit markets. Some lenders have reduced or, in some cases, ceased to provide funding to borrowers. We believe that we have adequate liquidity to meet our present needs. Continued turbulence in the United States and international financial markets, however, could adversely affect the cost and availability of financing to us in the future and limit our ability to acquire products, other assets, or businesses.

Cash provided by operations increased by \$14.7 million for the year ended December 31, 2009 to \$26.6 million, compared to \$11.8 million in 2008. The sum of our net income and certain non-cash expense items, such as reserves, depreciation and amortization, and share based compensation was approximately \$24.7 million in 2009, compared to \$26.4 million in 2008. The aggregate impact of changes in certain operating assets and liabilities was a cash inflow of \$1.9 million in 2009 compared to a cash outflow of \$14.6 million in 2008. In particular, while the carrying amounts of accounts receivable and inventory, exclusive of those items acquired in acquisitions, resulted in a use of cash of \$10.3 million in 2008, they resulted in a source of cash of \$662,000 in 2009.

Cash used in investing activities was \$51.8 million for the year ended December 31, 2009, compared to \$34.0 million in 2008. We used \$2.6 million and \$3.6 million of cash to acquire property and equipment, during the years ended December 31, 2009 and 2008, respectively. We used \$47.2 million of cash to acquire businesses during the year ended December 31, 2009 compared with \$29.0 million during the year ended December 31, 2008. During the year ended December 31, 2009 we recorded \$1.0 million of internal use software development costs compared with \$1.5 million in 2008. In addition, we purchased \$965,000 of marketable securities in 2009 and purchased and sold \$12.1 million of marketable securities during the year ended December 31, 2008.

Cash provided by financing activities was \$489,000 in the year ended December 31, 2009, compared to \$69.1 million in 2008. We raised an aggregate of \$99.3 million through underwritten registered public offerings of our common stock in April and May 2008 with no similar transactions in 2009. We received cash from sales of our stock pursuant to our stock awards plans and our employee stock purchase plan in the amount of \$1.1 million and \$2.9 million in the year ended December 31, 2009 and 2008, respectively. In 2009 our after-tax cost of stock-based compensation was \$159,000 more than the tax benefit we received from those arrangements, compared with an excess tax benefit of \$2.2 million in 2008. These amounts were recorded as a decrease to stockholders' equity in 2009 and as an increase to stockholders' equity in 2008. We repaid \$429,000 under term loan agreements in the year ended December 31, 2009. During the year ended December 31, 2008, we borrowed \$6.0 million under our revolving line of credit and we repaid \$25.2 million on our term loan agreements and \$16.1 million on our revolving credit facility.

***Future Liquidity***

Our future liquidity and capital requirements will depend on numerous factors, including the:

Amount and timing of revenue;

Extent to which our existing and new products gain market acceptance;

**Table of Contents**

Extent to which we make acquisitions;

Cost and timing of product development efforts and the success of these development efforts;

Cost and timing of marketing and selling activities; and

Availability of borrowings under line of credit arrangements and the availability of other means of financing.

**Contractual Obligations**

In the normal course of business, we enter into obligations and commitments that require future contractual payments. The commitments result primarily from firm, noncancellable purchase orders placed with contract vendors that manufacture some of the components used in our medical devices and related disposable supply products, as well as commitments for leased office equipment and term loans. The following table summarizes our contractual obligations and commercial commitments as of December 31, 2010 (in thousands):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Unconditional purchase obligations	\$ 15,667	\$ 13,998	\$ 804	\$ 356	\$ 509
Operating lease obligations	5,261	1,882	2,591	788	
Other contractual obligations	3,267	2,519	748		
Long-term liabilities (including interest)	1,569	756	813		
<b>Total</b>	<b>\$ 25,764</b>	<b>\$ 19,155</b>	<b>\$ 4,956</b>	<b>\$ 1,144</b>	<b>\$ 509</b>

Purchase obligations are defined as agreements to purchase goods or services that are enforceable and legally binding. Included in the purchase obligations category above are obligations related to purchase orders for inventory purchases under our standard terms and conditions and under negotiated agreements with vendors. We expect to receive consideration (products or services) for these purchase obligations. The purchase obligation amounts do not represent all anticipated purchases in the future, but represent only those items for which we are contractually obligated. The table above does not include obligations under employment agreements for services rendered in the ordinary course of business.

We are not able to reasonably estimate the timing of any potential payments for uncertain tax positions under ASC 740, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109*. As a result, the preceding table excludes any potential future payments related to our ASC 740 liability for uncertain tax positions. See Note 14 of our consolidated financial statements for further discussion on income taxes.

**Quantitative and Qualitative Disclosures about Market Risk**

We develop products in the U.S, Canada, Argentina, and Europe and sell those products into more than 100 countries throughout the world. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Most of our sales in Europe and Asia are denominated in U.S. Dollars and Euros and with the acquisitions of Xltek in November 2007 and Medix in 2010, a small portion of our sales are now denominated in Canadian dollars and Argentine pesos. As our sales in currencies other than the U.S. dollar increase, our exposure to foreign currency fluctuations may increase.

In addition, changes in exchange rates also may affect the end-user prices of our products compared to those of our foreign competitors, who may be selling their products based on local currency pricing. These factors may make our products less competitive in some countries.

## **Table of Contents**

If the U.S. Dollar uniformly increased or decreased in strength by 10% relative to the currencies in which our sales were denominated, our net income would have correspondingly increased or decreased by an immaterial amount for the year ended December 31, 2010. Our interest income is sensitive to changes in the general level of interest rates in the U.S. However, because current market conditions have resulted in historically low rates of return on our investments, a hypothetical decrease of 10% in market interest rates would not result in a material decrease in interest income earned on investments held at December 31, 2010.

When able, we invest excess cash in bank money-market funds or discrete short-term investments. The fair value of our short-term investments and cash equivalents ( investments ) is sensitive to changes in the general level of interest rates in the U.S., and the fair value of these investments will fall if market interest rates increase. However, since we generally have the ability to hold the investments to maturity, these declines in fair value may never be realized. If market interest rates were to increase by 10% from levels at December 31, 2010, the fair value of our investments would decline by an immaterial amount.

All of the potential changes noted above are based on sensitivity analyses performed on our financial position as of December 31, 2010. Actual results may differ as our analysis of the effects of changes in interest rates does not account for, among other things, sales of securities prior to maturity and repurchase of replacement securities, the change in mix or quality of the investments in the portfolio, and changes in the relationship between short-term and long-term interest rates.

## **Off-Balance Sheet Arrangements**

Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director s serving in such capacity. We have a directors and officers liability insurance policy that limits our exposure and enables us to recover a portion of any future amounts paid resulting from the indemnification of our officers and directors. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. In some cases we have obtained liability insurance providing coverage that limits our exposure for these other indemnified matters. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these indemnification agreements is minimal and have not recorded a liability for these agreements as of December 31, 2010. We had no other off-balance sheet arrangements during any of fiscal 2010, 2009 or 2008 that had, or are reasonably likely to have, a material effect on our consolidated financial condition, results of operations, or liquidity.

## **Recent Accounting Pronouncements**

See *Note 1 Organization and Significant Accounting Policies* to the Consolidated Financial Statements contained herein for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of our operations and financial condition.

**Table of Contents**

**Cautionary Information Regarding Forward Looking Statements**

*This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 about Natus Medical Incorporated. These statements include, among other things, statements concerning our expectations, beliefs, plans, intentions, future operations, financial condition and prospects, and business strategies. The words may, will, continue, estimate, project, intend, believe, expect, anticipate, and other similar expressions generally identify forward-looking statements. Forward-looking statements in this Item 7 include, but are not limited to, statements regarding the following: our ability to capitalize on improving market conditions, the sufficiency of our current cash, cash equivalents and short-term investment balances, and any cash generated from operations to meet our ongoing operating and capital requirements for the foreseeable future, and our intent to acquire additional technologies, products or businesses.*

*Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause the actual results predicted in the forward-looking statements as well as our future financial condition and results of operations to differ materially from our historical results or currently anticipated results. Investors should carefully review the information contained under the caption Risk Factors contained in Item 1A of this report for a description of risks and uncertainties. All forward-looking statements are based on information available to us on the date hereof, and we assume no obligation to update forward-looking statements.*

**ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk**

The information required by this Item is set forth in the section entitled *Management's Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures About Market Risk*, and is incorporated by reference in this section.

**ITEM 8. Financial Statements and Supplementary Data**

The Consolidated Financial Statements and Supplementary Data required by this Item are set forth where indicated in Item 15 of this report.

**Table of Contents****Selected Quarterly Financial Data (Unaudited)**

The following table presents our operating results for each of the eight quarters in the period ending December 31, 2010. The information for each of these quarters is unaudited and has been prepared on the same basis as our audited financial statements appearing elsewhere in this report. As discussed in Note 20, *Immaterial Corrections to Prior Period Financial Statements* in the *Notes to Consolidated Financial Statements* of our Consolidated Financial Statements contained herein, subsequent to the issuance of our consolidated financial statements for the fiscal year ended December 31, 2009 and our quarterly consolidated financial statements for the quarter ended September 30, 2010, we discovered immaterial errors in previously issued financial statements. These errors were corrected for all quarters and years that were affected. The quarterly information presented below reflects the correction of these errors. The impact of the errors was immaterial to all of the period presented.

In the opinion of our management, all necessary adjustments, consisting only of normal recurring adjustments, other than the correction discussed in the preceding paragraph, have been included to present fairly the unaudited quarterly results when read in conjunction with our audited consolidated financial statements and the related notes appearing elsewhere in this report. These operating results are not necessarily indicative of the results of any future period.

	Quarters Ended							
	Dec. 31, 2010	Sept. 30, 2010	June 30, 2010	March 31, 2010	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	March 31, 2009
	(in thousands, except per share)							
Revenue	\$ 63,170	\$ 53,179	\$ 53,031	\$ 49,275	\$ 51,449	\$ 44,251	\$ 37,263	\$ 33,462
Cost of revenue	25,998	21,757	21,532	19,411	21,860	17,617	13,772	12,828
Gross profit	37,172	31,422	31,499	29,864	29,589	26,634	23,491	20,634
Gross profit percentage	58.8%	59.1%	59.4%	60.6%	57.5%	60.2%	63.0%	61.7%
Operating expenses:								
Marketing and selling	14,523	12,817	13,553	13,964	13,298	11,661	10,171	10,174
Research and development	6,095	4,820	5,238	5,130	4,878	4,176	3,955	3,723
General and administrative	9,111	8,074	7,791	11,010	6,652	5,527	5,280	5,520
Total operating expenses	29,729	25,711	26,582	30,104	24,828	21,364	19,406	19,417
Income (loss) from operations	7,443	5,711	4,917	(240)	4,761	5,270	4,085	1,217
Other income (expense), net	(127)	(176)	240	(55)	1,166	71	387	126
Income (loss) before provision for income tax	7,316	5,535	5,157	(295)	5,927	5,341	4,472	1,343
Provision for income tax	2,067	1,898	1,793	36	1,987	1,736	1,495	483
Net income (loss)	\$ 5,249	\$ 3,637	\$ 3,364	\$ (331)	\$ 3,940	\$ 3,605	\$ 2,977	\$ 860
Earnings (loss) per share:								
Basic	\$ 0.19	\$ 0.12	\$ 0.12	\$ (0.01)	\$ 0.14	\$ 0.13	\$ 0.11	\$ 0.03
Diluted	\$ 0.18	\$ 0.12	\$ 0.12	\$ (0.01)	\$ 0.14	\$ 0.13	\$ 0.10	\$ 0.03
Weighted average shares used in the calculation of net earnings per share:								
Basic	28,303	28,212	27,809	27,829	27,686	27,669	27,644	27,606
Diluted	29,297	29,261	29,110	27,829	28,769	28,668	28,276	28,136
Impact of error corrections:								
Net Income								
As previously reported		\$ 3,743	\$ 3,105	\$ (303)	\$ 4,287	\$ 3,669	\$ 2,336	\$ 787

Edgar Filing: NATUS MEDICAL INC - Form 10-K

As corrected	\$ 3,637	\$ 3,364	\$ (331)	\$ 3,940	\$ 3,605	\$ 2,977	\$ 860
<b>Diluted earnings (loss) per share</b>							
As previously reported	\$ 0.12	\$ 0.12	\$ (0.01)	\$ 0.15	\$ 0.14	\$ 0.08	\$ 0.03
As corrected	\$ 0.12	\$ 0.12	\$ (0.01)	\$ 0.14	\$ 0.13	\$ 0.10	\$ 0.03

## **Table of Contents**

We acquired Medix in October 2010, Alpine Biomed in September 2009, and Hawaii Medical in July 2009. Results of operations of each of the acquired entities are included in the above table from the date of acquisition forward.

### **ITEM 9A. Controls and Procedures Evaluation of Disclosure Controls and Procedures**

Under the rules of the Securities and Exchange Commission, disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2010. Our chief executive officer and chief financial officer determined that as of December 31, 2010 our disclosure controls and procedures were effective for the purpose set forth above.

### **Internal Control Over Financial Reporting**

#### ***(a) Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15-(f) promulgated under the Securities Exchange Act of 1934. Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we assessed the effectiveness of our internal control over financial reporting as of December 31, 2010. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the *Internal Control-Integrated Framework*. Our management has concluded that, as of December 31, 2010, our internal control over financial reporting is effective based on these criteria.

We acquired Medix Industrial y Commercial S.A. ( Medix) in October 2010 and as permitted by SEC guidance, we excluded from our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2010, the internal control over financial reporting of this entity. Total assets including goodwill and intangible assets related to Medix of \$30.2 million as of December 31, 2010, and revenue of \$7.1 million for the period from the date of acquisition to December 31, 2010, were included in our consolidated financial statements as of and for the year ended December 31, 2010. Our assessment of our internal control over financial reporting excluded an evaluation of the internal control over financial reporting of this entity as of December 31, 2010.

Our independent registered public accounting firm, Deloitte & Touche LLP, have audited the consolidated financial statements and financial statement schedule included in this annual report. They also audited the effectiveness of our internal control over financial reporting as of December 31, 2010 as stated in their report included in this annual report.

#### ***(b) Attestation Report of the Independent Registered Public Accounting Firm***



---

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Natus Medical Incorporated

San Carlos, California

We have audited the internal control over financial reporting of Natus Medical Incorporated and subsidiaries (the Company) as of December 31, 2010, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management's Report on Internal Control Over Financial Reporting, management excluded from its assessment the internal control over financial reporting of Medix I.C.S.A. (Medix) which was acquired on October 12, 2010, whose financial statements constitute 10% of total assets, 5% of net assets, 3% of revenues, and 2% of net income of the consolidated financial statement amounts as of and for the year ended December 31, 2010. Accordingly, our audit did not include the internal control over financial reporting at Medix. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and the financial statement schedule at Item 15(a)(2) of this annual report as of and for the year ended December 31, 2010 of the Company and our report dated March 14, 2011 expressed an unqualified opinion on those financial statements and the financial statement schedule and included an explanatory paragraph relating to the adoption of Accounting Standards Codification Topic 805, Business Combinations (formerly SFAS 141R).

/s/ DELOITTE & TOUCHE LLP

San Francisco, CA

March 14, 2011



**Table of Contents**

*(c) Changes in Internal Control over Financial Reporting*

There was no change in internal control over financial reporting that occurred during the fourth quarter of 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART III**

This Part incorporates certain information from our definitive Proxy Statement for our 2011 Annual Meeting of Stockholders that is to be filed with the Securities and Exchange Commission not later than 120 days after the end of our fiscal year covered by this Report on Form 10-K.

**ITEM 10. Directors, Executive Officers, and Corporate Governance**

The information required by this Item concerning our directors is incorporated by reference to our Proxy Statement including but not necessarily limited to the section entitled *Election of Directors*. Certain information required by this item concerning executive officers is set forth in Part I of this Report in *Business Executive Officers*. The information required by this item concerning compliance with Section 16(a) of the Exchange Act of 1934, as amended (the Exchange Act), is incorporated by reference to the Proxy Statement including but not necessarily limited to the section entitled *Section 16(a) Beneficial Ownership Reporting Compliance*.

***Audit Committee and Audit Committee Financial Expert***

The members of the Audit Committee of our Board of Directors are Ken Ludlum, Robert A. Gunst, and Mark D. Michael. Our Board of Directors has determined that Ken Ludlum is an audit committee financial expert as defined in Item 407(d) of Regulation S-K. All of the members of our audit committee are considered independent as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

***Code of Conduct and Ethics***

We have a code of conduct and ethics that applies to all of our employees, including our principal executive officer, principal financial officer, and principal accounting officer or controller. This code of conduct and ethics is posted on our internet website. The internet address for our website is [www.natus.com](http://www.natus.com), and the code of conduct and ethics may be found in the Governance section of our Investor webpage.

We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding certain amendments to, or waivers from, provisions of this code of conduct and ethics by posting such information on our website, at the address and location specified above, or as otherwise required by The Nasdaq Stock Market.

The information required by this Item concerning our corporate governance is incorporated by reference to our Proxy Statement including but not necessarily limited to the section entitled *Corporate Governance*.

**ITEM 11. Executive Compensation**

The information required by this Item is incorporated by reference to our 2011 Proxy Statement including but not necessarily limited to the section entitled *Executive Compensation*.

**ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters  
Equity Compensation Plan Information**

The following table provides information as of December 31, 2010 about our common stock that may be issued upon the exercise of options, warrants, awards, and rights under all of our existing equity compensation plans, including the 1991 Stock Option Plan, 2000 Stock Awards Plan, 2000 Supplemental Stock Option Plan, 2000 Director Option Plan, and 2000 Employee Stock Purchase Plan, each as amended.

**Table of Contents**

<b>Plan Category</b>	<b>Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants, Awards and Rights</b>	<b>Weighted-Average Exercise Price of Outstanding Options, Warrants Awards and Rights</b>	<b>Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (excluding securities reflected in the first column)</b>
Equity compensation plans approved by security holders	3,710,257	\$ 10.94	7,581,417
Equity compensation plans not approved by security holders			
<b>Total</b>	<b>3,710,257</b>	<b>\$ 10.94</b>	<b>7,581,417</b>

Of the shares of common stock to be issued upon exercise of outstanding options, warrants, awards and rights, 3,000,000 shares related to outstanding options under our 1991 Stock Option Plan, 3,330,957 shares related to outstanding options under our 2000 Stock Awards Plan, and 305,000 shares related to outstanding options under our 2000 Director Option Plan.

Of the shares of common stock remaining available for future issuance under equity compensation plans, 2,857,888 shares remained available for future issuance under our 2000 Stock Awards Plan, 4,212,387 shares remained available for future issuance under our 2000 Employee Stock Purchase Plan and 511,142 remained available for future issuance under the Director Option Plan. The 1991 Stock Option Plan and 2000 Supplemental Stock Option Plan were terminated as to new grants in July 2001. The number of shares reserved for issuance pursuant to our 2000 Stock Awards Plan is subject to an automatic increase on the first day of our fiscal year in an amount equal to the lesser of (i) 1,500,000 shares of common stock; (ii) 7% of our outstanding shares of common stock on the last day of the prior fiscal year; or (iii) an amount determined by our board of directors. The number of shares reserved for issuance pursuant to our 2000 Director Option Plan is subject to an automatic increase on the first day of our fiscal year in an amount equal to the lesser of (i) 100,000 shares of common stock; (ii) one-half of one percent of our outstanding shares of common stock on the last day of the prior fiscal year; or (iii) an amount determined by our board of directors. The number of shares reserved for issuance pursuant to our 2000 Employee Stock Purchase Plan is subject to an automatic increase on the first day of our fiscal year in an amount equal to the lesser of (i) 650,000 shares of common stock; (ii) 4% of our outstanding shares of common stock on the last day of the prior fiscal year; or (iii) an amount determined by our board of directors. We are unable to ascertain with specificity the number of securities to be issued upon exercise of outstanding rights under, or the weighted average exercise price of outstanding rights under, the 2000 Employee Stock Purchase Plan.

Pursuant to their terms, the 2000 Stock Awards Plan, 2000 Director Plan, and 2000 Employee Stock Purchase Plan will terminate in July 2011.

Additional information required by this Item concerning ownership of our securities by certain beneficial owners and management is incorporated by reference to our 2011 Proxy Statement including but not necessarily limited to the section entitled *Beneficial Ownership of Common Stock*. Information concerning securities authorized for issuance under equity compensation plans is incorporated by reference to our 2011 Proxy Statement including but not necessarily limited to the section entitled *Equity Compensation Plan Information*.

**ITEM 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item is incorporated by reference to the 2011 Proxy Statement including but not necessarily limited to the section entitled *Corporate Governance Principles and Board Matters - Certain Relationships and Policies on Related Party Transactions*.

**ITEM 14. Principal Accountant Fees and Services**

The information required by this Item is incorporated by reference to the 2011 Proxy Statement including but not necessarily limited to the section entitled *Audit Fees*.

**Table of Contents****PART IV****ITEM 15. Exhibits, Financial Statement Schedules**  
*(a)(1) Financial Statements*

The following consolidated financial statements are filed as part of this Report:

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets</u>	F-3
<u>Consolidated Statements of Operations</u>	F-4
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income</u>	F-5
<u>Consolidated Statements of Cash Flows</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7
<i>(a)(2) Financial Statement Schedule</i>	

**SCHEDULE II: VALUATION AND QUALIFYING ACCOUNTS**

For the years ended December 31, 2010, 2009 and 2008

(in thousands)

	<b>Balance at Beginning of Period</b>	<b>Assumed Through Acquisitions</b>	<b>Additions Charged to Expense</b>	<b>Deductions</b>	<b>Balance at End of Period</b>
Year ended December 31, 2010					
Allowance for doubtful accounts	\$ 1,515	\$	\$ 592	\$ (464)	\$ 1,643
Accrued warranty costs	\$ 694	\$ 43	\$ 331	\$ (372)	\$ 696
Year ended December 31, 2009					
Allowance for doubtful accounts	\$ 1,056	\$	\$ 1,207	\$ (748)	\$ 1,515
Accrued warranty costs	\$ 1,076	\$ 44	\$ 542	\$ (968)	\$ 694
Year ended December 31, 2008					
Allowance for doubtful accounts	\$ 993	\$	\$ 304	\$ (241)	\$ 1,056
Accrued warranty costs	\$ 1,000	\$ 75	\$ 1,122	\$ (1,121)	\$ 1,076

*(a)(3) Exhibits*

<b>Exhibit No.</b>	<b>Exhibit</b>	<b>Filing</b>	<b>Incorporated By Reference</b>		<b>File Date</b>
			<b>Exhibit No.</b>	<b>File No.</b>	
2.1	Share Purchase Agreement dated October 12, 2010 by and between Natus Medical Incorporated, and Medix I.C.S.A.				
3.1	Natus Medical Incorporated Amended and Restated Certificate of Incorporation	S-1	3.1.1	333-44138	08/18/2000

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

3.2	Natus Medical Incorporated Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	8-A	3.1.2	000-33001	09/06/2002
3.3	Bylaws of Natus Medical Incorporated	8-K	3.1	000-33001	06/18/2008

**Table of Contents**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		
			Exhibit No.	File No.	File Date
4.1	Amended and Restated Preferred Stock Rights Agreement, dated as of October 8, 2002, between Natus Medical Incorporated and Equiserve Trust Company, N.A., including the form of Rights Certificate and Summary of Rights attached thereto as Exhibits B and C, respectively	8-A	4.1	000-33001	10/08/2002
4.2	Amendment No. 1 to the Amended and Restated Preferred Stock Rights Agreement dated as of February 14, 2003 between Natus Medical Incorporated and Equiserve Trust Company, N.A.	8-A	4.2	000-33001	02/25/2003
4.3	Amendment No. 2 to the Amended and Restated Preferred Stock Rights Agreement dated as of March 15, 2005 between Natus Medical Incorporated and Equiserve Trust Company, N.A.	8-K	99.1	000-33001	03/15/2005
4.4	Amendment No. 3 to the Amended and Restated Preferred Stock Rights Agreement dated as of August 17, 2006 between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	99.01	000-33001	08/17/2006
4.5	Registration Rights Agreement dated as of April 9, 2008 by and among Natus Medical Incorporated and D3 Family Funds	8-K	4.01	000-33001	04/09/2008
10.1	Form of Indemnification Agreement between Natus Medical Incorporated and each of its directors and officers	S-1	10.1	333-44138	08/18/2000
10.2*	Natus Medical Incorporated Amended and Restated 1991 Stock Option Plan	S-1	10.2	333-44138	08/18/2000
10.2.1*	Form of Option Agreement under the Amended and Restated 1991 Stock Option Plan	S-1	10.2.1	333-44138	08/18/2000
10.3*	Natus Medical Incorporated Amended and Restated 2000 Stock Awards Plan	8-K	10.1	000-33001	01/04/2006
10.3.1*	Form of Option Agreement under the Amended and Restated 2000 Stock Awards Plan	S-1	10.3.1	333-44138	08/18/2000
10.3.2*	Form of Restricted Stock Purchase Agreement under the Amended and Restated 2000 Stock Awards Plan	10-Q	10.2	000-33001	08/09/2006
10.3.3*	Form of Restricted Stock Unit Agreement under the Amended and Restated 2000 Stock Awards Plan	10-K	10.3.3	000-33001	03/14/2008
10.4*	Natus Medical Incorporated 2000 Director Option Plan	10-Q	10.02	000-33001	05/09/2008
10.4.1*	Form of Option Agreement under the 2000 Director Option Plan	S-1	10.4.1	333-44138	08/18/2000



**Table of Contents**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		
			Exhibit No.	File No.	File Date
10.5*	Natus Medical Incorporated 2000 Employee Stock Purchase Plan and form of subscription agreement thereunder	8-K	10.2	000-33001	01/04/2006
10.6	Lease Agreement dated August 24, 1998 between Natus Medical Incorporated and San Carlos Co-Tenancy	S-1	10.8	333-44138	08/18/2000
10.7	Amendment to Lease Agreement dated August 24, 1998 between Natus Medical Incorporated and San Carlos Co-Tenancy	10-K	10.8.1	000-33001	03/27/2003
10.8	6th Amendment to Lease Agreement dated July 1, 2005 between Natus Medical Incorporated and San Carlos Co-Tenancy	10-K	10.10	000-33001	03/16/2006
10.9*	Natus Medical Incorporated 2000 Supplemental Stock Option Plan	S-1	10.15	333-44138	08/18/2000
10.9.1*	Form of Option Agreement for 2000 Supplemental Stock Option Plan	S-1	10.15.1	333-44138	08/18/2000
10.10*	Form of Employment Agreement between Natus Medical Incorporated and each of its executive officers	10-K	10.1	000-33001	03/10/2009
10.11*	Amended Employment Agreement between Natus Medical Incorporated and James B. Hawkins dated April 25, 2008	8-K	99.1	000-33001	04/29/2008
10.12	Amended and Restated Credit Agreement dated November 28, 2007 by and between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	12/03/2007
10.13	Security Agreement dated November 28, 2007 by Natus Medical Incorporated in favor of Wells Fargo Bank, National Association	8-K	10.2	000-33001	12/03/2007
10.14	First Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	08/06/2008
10.15	Second Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	09/05/2008
10.16	Third Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-K	10.16	000-33001	03/10/2009
10.17	Amended and Restated Security Agreement dated February 19, 2009 in favor of Wells Fargo Bank, National Association	10-K	10.17	000-33001	03/10/2009

**Table of Contents**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		
			Exhibit No.	File No.	File Date
10.18	Fourth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	08/07/2009
10.19	Fifth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	09/11/2009
10.20	Sixth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	11/23/2009
10.21	Seventh Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-K	10.21	000-33001	03/15/2010
10.22	Second Amended and Restated Credit Agreement dated as of April 22, 2010 between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	04/27/2010
21.1	Subsidiaries of the Registrant				
23.1	Consent of Independent Registered Public Accounting Firm				
24.1	Power of Attorney				
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				

\* Indicates a management contract or compensatory plan or arrangement  
**(b) Exhibits**

See Item 15(a)(3) above.

**(c) Financial Statement Schedules**

See Item 15(a)(2) above.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

NATUS MEDICAL INCORPORATED

By /s/ James B. Hawkins  
**James B. Hawkins**

**President and Chief Executive Officer**

By /s/ Steven J. Murphy  
**Steven J. Murphy**

**Vice President Finance and Chief Financial Officer**

Dated: March 14, 2011

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints James B. Hawkins and Steven J. Murphy and each of them acting individually, as his or her attorney-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons on behalf of the registrant and in the capacity and dates indicated:

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ James B. Hawkins <b>(James B. Hawkins)</b>	Chief Executive Officer and Director (Principal Executive Officer)	March 14, 2011
/s/ Steven J. Murphy <b>(Steven J. Murphy)</b>	Vice President Finance & Chief Financial Officer (Principal Financial and Accounting Officer)	March 14, 2011
/s/ Robert A. Gunst <b>(Robert A. Gunst)</b>	Chairman of the Board of Directors	March 14, 2011
/s/ Doris Engibous <b>(Doris Engibous)</b>	Director	March 14, 2011
/s/ Ken Ludlum <b>(Ken Ludlum)</b>	Director	March 14, 2011

Edgar Filing: NATUS MEDICAL INC - Form 10-K

/s/ Mark D. Michael	Director	March 14, 2011
<b>(Mark D. Michael)</b>		
/s/ William M. Moore	Director	March 14, 2011
<b>(William M. Moore)</b>		

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets</u>	F-3
<u>Consolidated Statements of Operations</u>	F-4
<u>Consolidated Statements of Stockholders' Equity and Comprehensive Income</u>	F-5
<u>Consolidated Statements of Cash Flows</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

F-1

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Natus Medical Incorporated

San Carlos, California

We have audited the accompanying consolidated balance sheets of Natus Medical Incorporated and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Natus Medical Incorporated and subsidiaries at December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2009, the Company adopted Accounting Standards Codification 805, Business Combinations (formerly SFAS 141R).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2011, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

San Francisco, CA

March 14, 2011

**Table of Contents****NATUS MEDICAL INCORPORATED****CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 28,383	\$ 32,586
Short-term investments	1,005	965
Accounts receivable, net of allowance for doubtful accounts of \$1,643 and \$1,515	54,782	43,750
Inventories	37,627	23,089
Prepaid expenses and other current assets	4,954	3,825
Deferred income tax	2,192	4,166
<b>Total current assets</b>	<b>128,943</b>	<b>108,381</b>
Property and equipment, net	23,408	14,066
Intangible assets	69,428	70,144
Goodwill	96,819	92,258
Other assets	12,449	7,241
<b>Total assets</b>	<b>\$ 331,047</b>	<b>\$ 292,090</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 21,684	\$ 13,982
Current portion of long-term debt	156	178
Accrued liabilities	18,437	14,513
Deferred revenue	4,744	4,501
<b>Total current liabilities</b>	<b>45,021</b>	<b>33,174</b>
Long-term liabilities		
Other liabilities	8,076	7,575
Long-term debt	737	931
Deferred income tax	13,958	6,853
<b>Total liabilities</b>	<b>67,792</b>	<b>48,533</b>
Commitments and contingencies (Note 18)		
Stockholders' equity:		
Common stock, \$0.001 par value; 120,000,000 shares authorized; shares issued and outstanding: 28,922,667 in 2010 and 28,414,229 in 2009	258,872	250,374
Retained earnings	18,057	6,138
Accumulated other comprehensive (loss)	(13,674)	(12,955)
<b>Total stockholders' equity</b>	<b>263,255</b>	<b>243,557</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 331,047</b>	<b>\$ 292,090</b>

Edgar Filing: NATUS MEDICAL INC - Form 10-K

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

F-3



**Table of Contents**

**NATUS MEDICAL INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

	Years Ended December 31,		
	2010	2009	2008
Revenue	\$ 218,655	\$ 166,425	\$ 161,831
Cost of revenue	88,698	66,077	61,332
Gross profit	129,957	100,348	100,499
Operating expenses:			
Marketing and selling	54,857	45,304	39,998
Research and development	21,283	16,732	15,520
General and administrative	35,986	22,979	19,808
Total operating expenses	112,126	85,015	75,326
Income from operations	17,831	15,333	25,173
Other income (expense), net	(118)	1,750	2,142
Income before provision for income tax	17,713	17,083	27,315
Provision for income tax	5,794	5,701	10,033
Net income	\$ 11,919	\$ 11,382	\$ 17,282
Net income per share:			
Basic	\$ 0.42	\$ 0.41	\$ 0.68
Diluted	\$ 0.41	\$ 0.40	\$ 0.65
Weighted average shares used in the calculation of net income per share:			
Basic	28,092	27,651	25,278
Diluted	29,217	28,476	26,557

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

**Table of Contents****NATUS MEDICAL INCORPORATED****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY****AND COMPREHENSIVE INCOME****(In thousands, except share amounts)**

	Common Stock		Retained Earnings / (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Stockholders Equity	Comprehensive Income
	Shares	Amount				
Balances, December 31, 2007	21,956,771	\$ 137,837	\$ (22,526)	\$ 696	\$ 116,007	
Issuance of common stock	5,485,500	99,278			99,278	
Tax benefit of option exercises		2,222			2,222	
Issuance of restricted stock	143,334					
Employee stock purchase plan	39,552	548			548	
Compensation expense for stock options		2,995			2,995	
Exercise of stock options	368,024	2,316			2,316	
Foreign currency translation adjustment				(14,336)	(14,436)	\$ (14,336)
Net income			17,282		17,282	17,282
Comprehensive income						\$ 2,946
Balances, December 31, 2008	27,993,181	245,196	(5,244)	(13,640)	226,312	
Tax expense of options exercise		(159)			(159)	
Issuance of restricted stock	305,200					
Employee stock purchase plan	81,624	729			729	
Compensation expense for stock options		4,260			4,260	
Exercise of stock options	34,224	348			348	
Foreign currency translation adjustment				685	685	\$ 685
Net income			11,382		11,382	11,382
Comprehensive income						\$ 12,067
Balances, December 31, 2009	28,414,229	250,374	6,138	(12,955)	243,557	
Tax expense of options exercises		551			551	
Vesting of restricted stock units	8,750	31			31	
Issuance of restricted stock	209,600					
Employee stock purchase plan	68,050	866			866	
Compensation expense for stock options		5,399			5,399	
Exercise of stock options	222,038	1,651			1,651	
Foreign currency translation Adjustment				(719)	(719)	\$ (719)
Net income			11,919		11,919	11,919
Comprehensive income						\$ 11,200
Balances, December 31, 2010	28,922,667	\$ 258,872	\$ 18,057	\$ (13,674)	\$ 263,255	

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



**Table of Contents****NATUS MEDICAL INCORPORATED****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Year Ended December 31,		
	2010	2009	2008
<b>Operating activities:</b>			
Net income	\$ 11,919	\$ 11,382	\$ 17,282
Adjustments to reconcile net income to net cash provided by operating activities:			
Accounts receivable reserves	592	1,137	304
Excess tax (benefit)/expense on the exercise of stock options	(551)	159	(2,222)
Depreciation and amortization	9,156	7,884	6,764
Impairment of intangible assets	300		
(Gain)/loss on disposal of property and equipment	452	(29)	71
Warranty reserve	331	542	1,197
Change in fair value of contingent obligation		(600)	
Share-based compensation	5,399	4,260	2,995
Changes in operating assets and liabilities, net of assets and liabilities acquired in acquisitions:			
Accounts receivable	(3,231)	683	(8,336)
Inventories	(8,181)	25	(2,296)
Other assets	(1,161)	(34)	1,734
Accounts payable	(5,478)	457	(2,782)
Accrued liabilities	(448)	380	(2,657)
Deferred revenue	723	(153)	(1,296)
Deferred taxes	1,704	495	1,044
<b>Net cash provided by operating activities</b>	<b>11,526</b>	<b>26,588</b>	<b>11,802</b>
<b>Investing activities:</b>			
Acquisition of businesses, net of cash acquired	(13,415)	(47,222)	(28,996)
Acquisition of property and equipment	(4,152)	(2,609)	(3,593)
Acquisition of intangible assets	(344)	(1,003)	(1,451)
Purchases of short-term investments	(975)	(965)	(12,120)
Sales of short-term investments	975		12,120
<b>Net cash used in investing activities</b>	<b>(17,911)</b>	<b>(51,799)</b>	<b>(34,040)</b>
<b>Financing activities:</b>			
Proceeds from stock option exercises and ESPP	2,548	1,077	2,864
Proceeds from issuance of common stock, net of issuance cost			99,278
Excess tax benefit (expense) on the exercise of stock options	551	(159)	2,222
Borrowing on credit facility			6,000
Payments on borrowings	(1,403)	(429)	(41,259)
<b>Net cash provided by financing activities</b>	<b>1,696</b>	<b>489</b>	<b>69,105</b>
Exchange rate effect on cash and cash equivalents	486	393	(1,868)
<b>Net increase (decrease) in cash and equivalents</b>	<b>(4,203)</b>	<b>(24,329)</b>	<b>44,999</b>
Cash and cash equivalents, beginning of year	32,586	56,915	11,916
<b>Cash and cash equivalents, end of year</b>	<b>\$ 28,383</b>	<b>\$ 32,586</b>	<b>\$ 56,915</b>

Edgar Filing: NATUS MEDICAL INC - Form 10-K

Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 130	\$ 153	\$ 1,002
Cash paid for income taxes	\$ 5,050	\$ 957	\$ 5,519
Non-cash investing activities:			
Acquisition-related earnout obligations included in accrued liabilities	\$	\$	\$ 1,347
Contingent earnout obligations classified as liabilities	\$ 2,000	\$	\$

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

F-6

---

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended December 31, 2010, 2009 and 2008**

**1 ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

**Organization**

Natus Medical Incorporated ( Natus , the Company , we , our ) was incorporated in California in May 1987 and reincorporated in Delaware August 2000. Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, incubators to control the newborn s environment, and software systems for managing and tracking disorders and diseases for public health laboratories. The Company s headquarters are in San Carlos, California.

We have completed a number of acquisitions since 2003, consisting of either the purchase of a company, substantially all of the assets of a company or individual products or product lines. Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008; Hawaii Medical and Alpine Biomed in 2009; and Medix in 2010.

**Principles of Consolidation** The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities in the consolidated financial statements and the reported amount of revenue and expenses during the reporting period. Such estimates include allowances for potentially uncollectible accounts receivable, valuation of inventory, intangible assets, goodwill, share-based compensation, deferred income taxes, reserves for warranty obligations, and the provision for income taxes. Actual results could differ from those estimates.

**Revenue Recognition** Revenue, net of discounts, is recognized from sales of medical devices and supplies, including sales to distributors, when the following conditions have been met: a purchase order has been received, title has transferred, the selling price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Terms of sale for most domestic sales are FOB origin, reflecting that title and risk of loss are assumed by the purchaser at the shipping point; however, terms of sale for some neurology, sleep-diagnostic, and head cooling systems are FOB destination, reflecting that title and risk of loss are assumed by the purchaser upon delivery. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped ex works, in which title and risk of loss are assumed by the distributor at the shipping point.

We have historically applied the software revenue recognition rules as prescribed by Accounting Standards Codification ( ASC ) Subtopic 985-605 to sales of certain of our diagnostic neurology and hearing systems ( products containing embedded software ). In October 2009, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. ( ASU ) 2009-14, *Certain Revenue Arrangements That Include Software Elements*, which amended ASC Subtopic 985-605. This ASU removes tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of the software revenue recognition rules. We adopted the provisions of ASU 2009-14 prospectively on January 1, 2010 for new or significantly modified revenue arrangements. The

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

adoption did not have a significant impact on our revenue or results of operations for the year ended December 31, 2010. In the case of the Company's products containing embedded software, we have determined that the hardware and software components function together to deliver the products' essential functionality, and therefore, the revenue from the sale of these products no longer falls within the scope of the software revenue recognition rules. Our revenue recognition policies for sales of these products are now substantially the same as for our other tangible products.

Revenue from sales of certain of our products that remain within the scope of the software revenue recognition rules under ASC Subtopic 985-605 is not significant.

We previously accounted for arrangements with multiple deliverables under ASC Topic 605, where revenue was allocated to the deliverables based on vendor specific objective evidence ( VSOE ). In October 2009 the FASB issued ASU 2009-13, *Multiple Deliverable Revenue Arrangements*, which amends ASC Topic 605. We adopted the provisions of ASU 2009-13 prospectively on January 1, 2010 for new or significantly modified revenue arrangements. The adoption did not have a significant impact on our revenue or results of operations for the year ended December 31, 2010. Under the revenue recognition rules for tangible products as amended by ASU 2009-13, we now allocate revenue from arrangements with multiple deliverables to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. The principal deliverables in our multiple deliverable arrangements that qualify as separate units of accounting consist of (i) sales of medical devices and supplies, (ii) installation services, (iii) extended service and maintenance agreements, and (iv) upgrades to embedded software.

The new rules establish a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value ( VSOE ), (ii) third-party evidence of selling price ( TPE ), and (iii) best estimate of the selling price ( ESP ). VSOE of fair value is defined as the price charged when the same element is sold separately, or if the element has not yet been sold separately, the price for the element established by management having the relevant authority when it is probable that the price will not change before the introduction of the element into the marketplace. VSOE generally exists only when we sell the deliverable separately and is the price actually charged for that deliverable. We have previously established VSOE for substantially all of the deliverables in our multiple element arrangements; however, in the future we may rely on ESPs, reflecting our best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis, to establish the amount of revenue to allocate to the deliverable. TPE generally does not exist for our products because of their uniqueness.

For products shipped under FOB origin or EXW terms, delivery is generally considered to have occurred when shipped. Undelivered elements in our sales arrangements, which are not considered to be essential to the functionality of a product, generally include installation or training services that are performed after the related products have been delivered. Revenue related to undelivered installation services is deferred until such time as installation is complete at the customer's site. Revenue related to training services is recognized when the service is provided. Fair value for installation or training services is based on the price charged when the service is sold separately. The fair value of installation and training services is based upon billable hourly rates and the estimated time to complete the service.

Revenue from extended service and maintenance agreements, for both medical devices and data management systems, is recognized ratably over the service period. Freight charges billed to customers are included in revenue and freight-related expenses are charged to cost of revenue. Advance payments from customers are recorded as deferred revenue and recognized as revenue as otherwise described above. We

---

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

generally do not provide rights of return on products. We accept trade-ins of our own and competitive medical devices. Trade-ins are recorded as a reduction of the replacement medical device sale. Provisions are made for initial standard warranty obligations that are generally one year in length.

More than 90% of the hospitals in the U.S. are members of Group Purchasing Organizations ( GPO s), which negotiate volume purchase prices for member hospitals, group practices, and other clinics. Our agreements with GPOs typically contain preferential terms for the GPO and its members, including provisions for some, if not all, of the following:

Negotiated pricing for all group members;

Volume discounts and other preferential terms on their member s direct purchases from us;

Promotion of Natus products by the GPO to its members;

Payment of marketing fees by Natus to the GPO, usually based on purchasing experience of group members; and

Non-recourse cancellation provisions.

We do not sell products to GPOs. Hospitals, group practices, and other clinics that are members of a GPO purchase products directly from the Company under the terms negotiated by the GPO. Negotiated pricing and discounts are recognized as a reduction of the selling price of products at the time of the sale. Revenue from sales to members of GPOs is otherwise consistent with general revenue recognition policies as previously described.

**Cash and Cash Equivalents** All highly liquid debt instruments purchased with an original maturity of three months or less are classified as cash equivalents.

**Short-Term Investments** Fixed-rate guaranteed investment contracts with a commercial bank with a maturity of one year, valued at cost plus accrued interest that approximates fair value are classified as short-term investments.

**Allowance for Doubtful Accounts** We assess the sufficiency of the allowance for estimated uncollectible accounts receivable. Estimates are based on historical collection experience within the markets in which we operate and other customer-specific information, such as bankruptcy filings or liquidity problems of customers. When it is determined that an account receivable is uncollectible, it is written off and relieved from the reserve. Any future determination that the allowance for estimated uncollectible accounts receivable is not properly stated could result in changes in operating expense and results of operations.

**Fair Value of Financial Instruments** Financial instruments include cash and cash equivalents, short-term investments, accounts receivable, and accounts payable. Cash and cash equivalents are reported at their respective fair values on the balance sheet dates. The recorded carrying amount of accounts receivable and accounts payable approximates their fair value due to their short-term maturities.

**Inventories** Inventories are stated at the lower of standard cost, which approximates actual cost on a first-in, first-out basis, or market. We may be exposed to a number of factors that could result in portions of our inventory becoming either obsolete or in excess of anticipated usage. These



## Edgar Filing: NATUS MEDICAL INC - Form 10-K

factors include, but are not limited to, technological changes, competitive pressures in products and prices, and the introduction of new product lines. We regularly evaluate our ability to realize the value of inventory based on a combination of factors, including historical usage rates, forecasted sales, product life cycles, and market acceptance of new products.

F-9

---

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

When inventory that is obsolete or in excess of anticipated usage is identified, it is written down to realizable salvage value or an inventory valuation reserve is established.

**Property and Equipment** Property and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using the straight-line method over estimated useful lives of the respective assets, which are three to five years for office furniture and equipment, three to five years for computer software and hardware, three to six years for demonstration and loaned equipment, and 40 years for buildings. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life. Land is not depreciated. Costs associated with acquiring and installing software to be used for internal purposes are capitalized.

**Long-Lived Assets and Goodwill** Intangible assets with finite lives are amortized over their useful lives; any future changes that would limit their useful lives or any determination that these assets are carried at amounts greater than their estimated fair value could result in impairment charges. Goodwill and any other intangible assets with indefinite lives are recorded at original cost and are not amortized. Any future determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges, which could impact operating results.

Definite-lived intangible assets are tested for impairment whenever changes in circumstances indicate the carrying value of these assets may be impaired. Impairment indicators include, but are not limited to, net book value as compared to market capitalization, significant negative industry and economic trends, and significant underperformance relative to historical and projected future operating results. Impairment is considered to have occurred when the estimated undiscounted future cash flows related to the asset are less than its carrying value. Estimates of future cash flows involve consideration of many factors including the marketability of new products, product acceptance and lifecycle, competition, appropriate discount rates, and operating margins.

Intangible assets with definite lives are amortizing using the straight-line and graded methods over periods ranging from seven to 20 years.

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually as of October 1st; this assessment is also performed whenever there is a change in circumstances that indicates the carrying value of these assets may be impaired. The determination of whether any potential impairment of goodwill exists is based upon a two step process. In the first analysis, the fair value of the reporting unit is compared to the unit's carrying value, including goodwill, to determine if there is a potential impairment. If the fair value exceeds the carrying amount, the goodwill of the reporting unit is considered not impaired and no further analysis or action is required. If the first analysis indicates that the carrying value exceeds the fair value, a second analysis is performed to determine the amount of the goodwill impairment loss, if any.

In step two of the impairment test, the implied fair value of a reporting unit's goodwill is compared to the carrying amount of that goodwill. The implied fair value of the goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, the entity shall allocate the fair value of a reporting unit to all the assets and liabilities of that reporting unit, including unrecognized intangible assets as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of that goodwill.

To determine the estimated fair value of reporting units, three valuation methodologies are utilized: (i) discounted cash flow analyses, (ii) market multiples, and (iii) comparative transactions. The valuations

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

indicated by these three methodologies are averaged, with the greatest weight placed on discounted cash flow analyses. Discounted cash flow analyses are dependent upon a number of quantitative and qualitative factors including estimates of forecasted revenue, profitability, earnings before interest, taxes, depreciation and amortization (i.e. EBITDA) and exit values. The discount rates applied in the discounted cash flow analyses also have an impact on the estimates of fair value, as use of a higher rate will result in a lower estimate of fair value. The estimated total fair value of reporting units is reconciled to the Company's market capitalization.

Our discontinuance in 2010 of the Sonamed Clarity hearing screening line resulted in a write-off of the Sonamed Clarity tradename in the amount of \$300,000.

**Research & Development and Capitalized Software Development Costs** Costs incurred in research and development are charged to operations as incurred. Some of our products include imbedded software which is essential to the product's functionality. In accordance with FASB ASC 985-20, *Costs of Software to be Sold, Leased or Marketed*, costs incurred in the research and development of new software components and enhancements to existing software components are expensed as incurred until technological feasibility has been established. We capitalize software development costs when the project reaches technological feasibility and cease capitalization when the project is ready for release. Software development costs are amortized on a straight-line basis over the estimated useful life of the product. Amortization begins when the product is available for general release to the customer.

**Internal Use Software Development Costs** We account for internal use software development costs in accordance with ASC 350-40-15, *Internal Use Software*. In accordance with ASC 350-40-15, costs to develop internal use computer software during the application development stage are capitalized and reported as a component of intangible assets and amortized on a straight-line basis over the estimated useful lives of the related software applications.

**Share-Based Compensation** We amortize share-based compensation expense associated with employee stock options under the single-option straight line method over the requisite service period, which is generally a four-year vesting period pursuant to ASC Topic 718, *Compensation-Stock Compensation*. See Note 11.

For employee stock options, the value of each option is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of freely traded options. Our employee stock options have characteristics significantly different from those of traded options. Similar to other option pricing models, the Black-Scholes method requires the input of highly subjective assumptions, including stock price volatility. Changes in the subjective input assumptions can materially affect the estimated fair value of our employee stock options.

Forfeitures of employee stock options are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Share-based compensation expense is recorded net of estimated forfeitures, such that expense is recorded only for those share-based awards that are expected to vest.

The cash flow resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) is classified as a cash inflow from financing activities and a cash outflow from operating activities in our Statements of Cash Flows. We treat tax deductions from certain stock option exercises as being realized when they reduce taxes payable in accordance with relevant tax law.

We also recognize share-based compensation associated with Restricted Stock Awards and Restricted Stock Units in accordance with ASC Topic 718, *Compensation-Stock Compensation*.

---

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

**Uncertain Tax Positions** We recognize the tax benefit of uncertain tax positions in the financial statements in accordance with ASC Topic 740, *Income Tax*. When the tax position is deemed more likely than not of being sustained, we recognize the largest amount of tax benefit that is greater than 50 percent likely of being ultimately realized upon settlement, in accordance with ASC 740-10-05.

**Foreign Currency** The functional currency of our foreign subsidiaries is generally the local currency of the country where the subsidiary is located. Accordingly, foreign currency translation exchange adjustments relating to the translation of foreign subsidiary financial statements are included as a component of accumulated other comprehensive income (loss). We recorded \$(719,000), \$685,000, and \$(14.3) million of foreign currency translation adjustments for the years ended December 31, 2010, 2009 and 2008, respectively. We changed the functional currency of Xltek from the Canadian dollar to the U.S. Dollar on January 1, 2009.

Gains and losses from transactions denominated in currencies other than the functional currencies of the Company and its subsidiaries are included in other income and expense. In 2010, 2009 and 2008, net foreign currency transactions gains and (losses) were \$(521,000), \$520,000 and \$1,620,000, respectively. Foreign currency gains and losses result primarily from fluctuations in the exchange rate between the US Dollar, Canadian Dollar, Euro, Argentine Peso and Danish Kroner.

**Comprehensive Income** We report by major components and as a single total the change in our net assets during the period from non-owner sources in accordance with ASC Topic 220, *Comprehensive Income*. The consolidated statement of comprehensive income (loss) has been included with the consolidated statement of stockholders' equity. Accumulated other comprehensive income (loss) consists of net unrealized gains and losses on available-for-sale securities and translation gains and losses on foreign subsidiary financial statements.

**Basic and Diluted Net Income per Share** We compute net income per share in accordance with ASC Topic 260, *Earnings per Share*. Basic net income per share is based upon the weighted average number of common shares outstanding during the period. Diluted net income per share is based upon the weighted average number of common shares outstanding and dilutive common stock equivalents outstanding during the period. Common stock equivalents are options granted and shares of restricted stock issued under our stock awards plans and are calculated under the treasury stock method. Common equivalent shares from unexercised stock options and 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 year ended December 31, 2010, common stock equivalents of 1,125,006 were included in the weighted average shares outstanding used to calculate diluted income per share, while 1,090,401 shares were excluded from the calculation because of their anti-dilutive effect. For the year ended December 31, 2009, common stock equivalents of 824,516 were included in the weighted average shares outstanding used to calculate diluted income per share, while 1,168,704 shares were excluded from the calculation because of their anti-dilutive effect. For the year ended December 31, 2008, common stock equivalents of 1,206,000 were included in the weighted average shares outstanding used to calculate diluted income per share, while 525,000 shares were excluded from the calculation because of their anti-dilutive effect.

**Certain Significant Risks and Uncertainties** Financial instruments that potentially subject us to credit risk consist principally of cash and cash equivalents, short-term investments, and accounts receivable. Cash and cash equivalents consist primarily of cash in bank accounts and investments in money market funds. To minimize our exposure to credit risk, our short-term investments consists exclusively of highly liquid, investment-grade financial instruments.

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

We sell our products primarily to hospitals and medical institutions. Customers are generally not required to provide collateral or other security to support accounts receivable. Allowances for estimated potential bad debt losses are maintained. No single customer or distributor accounted for more than 10% of accounts receivable at December 31, 2010, 2009 or 2008.

**Recent Accounting Pronouncements**

In December 2010, the FASB issued Accounting Standards Update ( ASU ) 2010-28, *Intangibles Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. ASU 2010-28 modifies Step 1 of the goodwill impairment test so that for reporting units with zero or negative carrying amounts, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not based on an assessment of qualitative indicators that goodwill impairment exists. In determining whether it is more likely than not that goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that impairment may exist. ASU 2010-28 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. We do not expect adoption of this standard to have a material impact on our financial position, results of operations, or cash flows.

In February 2010, the FASB issued ASU 2010-09, *Subsequent Events* (Topic 855) which updates the guidance in ASC Topic 855, *Subsequent Events*, to no longer require companies that file with the SEC to indicate the date through which they have analyzed subsequent events. This updated guidance became effective immediately upon issuance.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements* (Topic 820): *Fair Value Measurement*. ASU 2010-06 requires new disclosures on the amount of and reason for transfers in and out of Level 1 and 2 fair value measurements, disclosure of activities, including purchases, sales, issuances, and settlements within Level 3 fair value measurements, and clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. The Company adopted ASU 2010-06 on January 1, 2010. The adoption of ASU 2010-06 did not impact our financial position, results of operations, and cash flows.

In December 2007, the FASB issued ASC Topic 805, *Business Combinations*, which expands the definition of a business combination and requires the fair value of the purchase price of an acquisition, including the issuance of equity securities, to be determined on the acquisition date. ASC Topic 805 also requires that all assets, liabilities, contingent consideration and contingencies of an acquired business be recorded at fair value at the acquisition date. In addition acquisition costs are generally expensed as incurred and restructuring costs generally are expensed in periods subsequent to the acquisition date. Changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties resulting from new information obtained during the measurement period about facts and circumstances that existed as of the acquisition date will result in an adjustment to goodwill, while all other changes in these items are recognized as adjustments to income tax expense. We adopted ASC Topic 805 on January 1, 2009.

**2 BUSINESS COMBINATIONS**

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

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

The Company acquired all of the capital stock of Medix for \$14.1 million in cash, excluding direct costs of the acquisition, with the potential for additional purchase consideration if certain revenue targets are met in 2011 and 2012. A total of \$297,000 of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

In accordance with ASC 805-10, the acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed from Medix at the date of acquisition are recorded in the consolidated financial statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill in the amount of \$4.8 million. Medix's results of operations are included in the consolidated financial statements from the date of the acquisition.

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

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

Cash	\$ 700
Accounts receivable	9,104
Inventories	8,283
Prepaid and other assets	128
Deferred income tax	152
Identifiable intangible assets:	
Technology	1,600
Customer-related	2,300
Tradenames	1,000
Land and building	7,160
Other property and equipment	359
Goodwill	4,834
Accounts payable	(13,485)
Accrued expenses	(1,861)
Other liabilities	(1,736)
Contingent earnout obligation-short-term	(1,252)
Deferred income tax	(2,446)
Contingent earnout obligation-long-term	(748)
<b>Total purchase price</b>	<b>\$ 14,092</b>

Valuing certain components of the acquisition, including primarily accounts receivable, inventory, identifiable intangible assets, real estate, deferred taxes, accrued warranty costs, accounts payable, other accrued expenses, and contingent earnout obligation required us to make estimates that may be adjusted in the future; consequently the purchase price allocation is considered preliminary. Final determination of these estimates could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to Goodwill. In addition, the purchase consideration paid to the sellers is subject to adjustment pursuant to a minimum working capital provision of the purchase agreement.



---

**Table of Contents**

**NATUS MEDICAL INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2010, 2009 and 2008**

*Identifiable intangible assets.* Intangible assets included in the purchase price allocation consist of: (i) technology of \$1.6 million assigned an average economic life of 20 years being amortized on the straight line method, (ii) customer-related intangible assets of \$2.3 million assigned an economic life of nine years being amortized on the straight line method, and (iii) tradenames of \$1.0 million that have an indefinite life and are not being amortized.

*Goodwill.* Approximately \$4.8 million has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. This goodwill is expected to be non-deductible for tax purposes. In accordance with ASC 350-20, goodwill will not be amortized but instead will be tested for impairment at least annually (more frequently if certain indicators are present). In the event that management determines that the value of goodwill has become impaired, we will incur an accounting charge for the amount of impairment during the fiscal quarter in which the determination is made.

*Deferred income tax.* A preliminary estimate of \$152,000 has been allocated to non-current deferred tax assets and \$2.4 million has been allocated to non-current deferred tax liabilities, which results primarily from the fair market value assigned to various assets including intangibles, land, and building.

*Contingent Earnout Obligation.* The Company is obligated to pay additional purchase consideration to the former shareholder of Medix if certain revenue targets are met in 2011 and 2012. We have recorded an estimate of the fair value of the contingent earnout obligation based on future revenue projections of the Medix business under various potential scenarios applying weighted probability assumptions of their outcomes. Actual amounts paid may differ from the obligation recorded.

**Alpine Biomed Holdings Corp.** We acquired Alpine Biomed Holdings Corp. ( Alpine Biomed ) on September 14, 2009 for \$43.2 million in cash pursuant to an Agreement and Plan of Merger. Alpine Biomed, with corporate headquarters in Fountain Valley, California and manufacturing facilities in Montreal, Canada, and Copenhagen, Denmark, is a leader in the development, manufacturing, and sales of devices for the diagnosis of neurological disorders. Alpine Biomed's broad range of products includes advanced electromyography systems for the diagnoses of peripheral nervous system dysfunctions as well as devices for routine EEG and long term epilepsy monitoring. The acquisition broadened our product offerings, primarily in electromyography and allows us to further leverage our existing sales channels both in the United States and internationally.

During 2010 we substantially completed a reorganization plan adopted in January 2010 that was designed to eliminate redundant costs resulting from our acquisition of Alpine Biomed and to improve efficiencies in operations. Under the plan, Alpine operations in Fountain Valley were moved to our corporate headquarters in San Carlos, California, Alpine's sales organization was merged into the Company's global sales organization, and Alpine operations in Montreal, Canada were transitioned to our existing Xltek facility in Oakville, Ontario, Canada.

We acquired all outstanding shares of Alpine Biomed capital stock for \$43.2 million in cash. A total of \$345,000 of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

In accordance with ASC 805-10, the acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed from Alpine Biomed at the date of acquisition are recorded in the consolidated financial statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill in the amount of \$28.8 million. This goodwill is expected to be non-deductible for tax purposes. Alpine Biomed's results of operations are included in the consolidated financial statements from the date of the acquisition.



**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

The Agreement and Plan of Merger also included an earnout provision based on the achievement of a certain revenue target as of December 31, 2009, however, the revenue target was not achieved and no additional cash consideration was paid.

In finalizing the purchase price allocation during 2010, we recorded adjustments to the original estimate of the purchase price allocation of the fair value of the assets acquired and liabilities assumed that decreased the carrying amount of goodwill by \$34,000, due to adjustments to inventories, accounts payable, deferred taxes, and accrued expenses.

The following unaudited pro forma combined results of operations of Natus for the twelve months ended December 31, 2010 and 2009 are presented as if the acquisitions of Medix and Alpine Biomed had occurred on the first day of the periods presented:

**Unaudited Pro Forma Financial Information**

(in thousands)

	December 31,	
	2010	2009
Revenue	\$ 236,452	\$ 227,723
Income from operations	\$ 20,436	\$ 15,644

The unaudited pro forma financial information is provided for comparative purposes only and is not necessarily indicative of what actual results would have been had the acquisitions occurred on the dates indicated, nor do they give effect to synergies, cost savings, and other changes expected to result from the acquisitions. Accordingly, the pro forma financial results do not purport to be indicative of results of operations as of the date hereof, for any period ended on the date hereof, or for any other future date or period. For purposes of preparing the Medix unaudited pro forma financial information for the years ended December 31, 2010, Medix's Statement of Income for the period January 1, 2010 through October 12, 2010 was combined with the Company's Consolidated Statement of Operations for the year ended December 31, 2010, which includes the results of Medix from the date of the acquisition. For the year ended December 31, 2009, Medix's Statement of Income for the period January 1, 2009 through October 31, 2009 was combined with Medix's Statement of Income for period November 1, 2009 through December 31, 2009. Alpine Biomed is included in the Company's Consolidated Statement of Operations for the year ended December 31, 2010. For purposes of preparing the Alpine unaudited pro forma financial information for the year ended December 31, 2009, Alpine's neurology business unaudited Statement of Sales and Direct Operating Expenses for the period January 1, 2009 through September 13, 2009 was combined with the Company's consolidated Statement of Operations for the year ended December 31, 2009, which includes the results of Alpine from the date of the acquisition.

**Hawaii Medical** We acquired Hawaii Medical, LLC (Hawaii Medical) on July 2, 2009 pursuant to an Agreement and Plan of Merger. Massachusetts based Hawaii Medical manufactures and markets single-use disposable products sold into the NICU and nursery in hospitals. During the third quarter 2009 we transitioned substantially all of the operations of Hawaii Medical to our Olympic facility in Seattle, Washington.

We acquired all outstanding units of Hawaii Medical for \$2.9 million in cash. In addition to the purchase price paid at closing, an earnout provision of the purchase agreement may result in additional cash consideration depending upon the achievement of certain revenue targets over a 36 month period. Although there is no limit to the additional consideration that will be paid if the revenue targets are exceeded, no contingent obligation was

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

recorded as there is significant uncertainty that the revenue targets will be achieved. As of December 31, 2010, the revenue targets were not achieved. We also incurred \$115,000 of direct costs associated with the acquisition that were expensed as a component of general and administrative expense in the third quarter 2009.

The acquisition has been accounted for as a purchase business combination. Under the purchase method of accounting, the assets acquired and liabilities assumed from Hawaii Medical at the date of acquisition are recorded in the consolidated financial statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill in the amount of \$2.4 million. This goodwill is expected to be non-deductible for tax purposes. Hawaii Medical's results of operations are included in the consolidated financial statements from the date of the acquisition.

**3 INVENTORIES**

Inventories consist of (in thousands):

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
Raw materials and subassemblies	\$ 14,924	\$ 12,187
Finished goods	26,375	14,994
<b>Total Inventories</b>	<b>41,299</b>	<b>27,181</b>
Less: Non-current Inventories	(3,672)	(4,092)
<b>Inventories</b>	<b>\$ 37,627</b>	<b>\$ 23,089</b>

At December 31, 2010, the Company has classified \$3.7 million of inventories as non-current. This inventory consists primarily of service components used to repair products held by our customers pursuant to warranty obligations and extended service contracts, including service components for products we are not currently selling. Management believes that these inventories will be utilized for their intended purpose.

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

**4 PROPERTY AND EQUIPMENT**

Property and equipment consist of (in thousands):

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
Land	\$ 4,903	\$ 3,403
Buildings	10,904	4,691
Leasehold improvements	2,523	1,479
Office furniture and equipment	9,067	7,898
Computer software and hardware	6,084	5,091
Demonstration and loaned equipment	7,571	6,286

Edgar Filing: NATUS MEDICAL INC - Form 10-K

	41,052	28,848
Accumulated depreciation	(17,644)	(14,782)
Total	\$ 23,408	\$ 14,066

F-17

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

Depreciation expense of property and equipment was \$3.7 million, \$3.1 million and \$3.2 million in the years ending December 31, 2010, 2009 and 2008, respectively.

**5 GOODWILL**

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

	Year Ended December 31,	
	2010	2009
Balance, beginning of period	\$ 92,258	\$ 60,858
Goodwill as a result of acquisitions	4,834	28,856
Purchase accounting adjustments	(14)	2,486
Foreign currency translation adjustment	(259)	58
<b>Total changes in goodwill</b>	<b>4,561</b>	<b>31,400</b>
Balance, end of period	\$ 96,819	\$ 92,258

**6 INTANGIBLE ASSETS**

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

	December 31, 2010			December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Intangible assets with definite lives:						
Technology	\$ 50,301	\$ (14,520)	\$ 35,781	\$ 48,207	\$ (10,970)	\$ 37,237
Customer related	15,299	(3,016)	12,283	13,448	(2,090)	11,358
Internally developed software	3,831	(1,392)	2,439	3,244	(565)	2,679
Patents	2,571	(1,746)	825	3,455	(1,595)	1,860
Definite lived intangible assets	72,002	(20,674)	51,328	68,354	(15,220)	53,134
Intangible assets with indefinite lives:						
Tradenames	18,100		18,100	17,010		17,010
<b>Total intangibles assets</b>	<b>\$ 90,102</b>	<b>\$ (20,674)</b>	<b>\$ 69,428</b>	<b>\$ 85,364</b>	<b>\$ (15,220)</b>	<b>\$ 70,144</b>

Definite lived intangible assets are amortized over their weighted average lives of 14 years for patents, 15 years for technology, 10 years for customer-related intangibles and 5 years for internally developed software. Intangible assets with indefinite lives are not subject to amortization.

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

Internally developed software consists of \$2.9 million relating to costs incurred for development of internal use computer software and \$943,000 for development of software to be sold.

F-18

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

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

	Years Ended December 31,		
	2010	2009	2008
Technology	\$ 3,550	\$ 3,382	\$ 2,105
Customer Related	926	631	582
Software	827	474	91
Patents	151	280	827
<b>Total amortization</b>	<b>\$ 5,454</b>	<b>\$ 4,767</b>	<b>\$ 3,605</b>

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

2011	\$ 5,398
2012	5,398
2013	5,273
2014	4,959
2015	4,119
Thereafter	26,181
<b>Total expected annual amortization expense</b>	<b>\$ 51,328</b>

**7 ACCRUED LIABILITIES**

Accrued liabilities consist of (in thousands):

	December 31,	
	2010	2009
Compensation and related benefits	\$ 8,530	\$ 7,155
Accrued contingent consideration	1,252	
Accrued federal, state, and local taxes	1,697	2,050
Warranty reserve	696	694
Accrued professional fees	272	1,002
Other	5,990	3,612
<b>Total</b>	<b>\$ 18,437</b>	<b>\$ 14,513</b>

**8 LONG-TERM OTHER LIABILITIES**

Long-term other liabilities consist of (in thousands):

Edgar Filing: NATUS MEDICAL INC - Form 10-K

	December 31,	
	2010	2009
Contingent tax obligations	\$ 6,383	\$ 6,037
Non-current deferred revenue	945	837
Accrued contingent consideration	748	
Contractual obligations		670
Other		31
Total	\$ 8,076	\$ 7,575

F-19

Table of Contents

## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2010, 2009 and 2008

**9 RESERVE FOR PRODUCT WARRANTIES**

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

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

Detail of activity in product warranty reserve is as follows, (in thousands):

	Balance at Beginning of Period	Assumed Through Acquisitions	Additions Charged to Expense	Reductions	Balance at End of Period
Year ended December 31, 2010					
Accrued warranty costs	\$ 694	\$ 43	\$ 331	\$ (372)	\$ 696

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

**10 STOCKHOLDERS EQUITY**

**Common Stock** We have 120,000,000 shares of common stock authorized at a par value of \$0.001 per share. We issued 885,500 shares of our common stock in a registered offering in April 2008 at an offering price of \$18.27 per share, raising approximately \$15.2 million, net of underwriting fees and other costs. In May 2008, we issued 4,600,000 shares of our common stock in a registered offering at an offering price of \$19.50 per share, raising approximately \$84.1 million, net of underwriting fees and other costs of the offering.

**Preferred Stock** We have 10,000,000 shares of preferred stock authorized at a par value of \$0.001 per share. In accordance with the terms of the amended and restated certificate of incorporation, the Board of Directors is authorized to provide for the issuance of one or more series of preferred stock, including increases or decreases to the series. The Board of Directors has the authority to set the rights, preferences, and terms of such shares. As of December 31, 2010, no shares of preferred stock were issued and outstanding.

**Stockholder Rights Plan** We adopted a Stockholder Rights Plan in September 2002 (the Rights Plan) that was amended most recently in September 2006. Pursuant to the Rights Plan, we declared a dividend of one Preferred Stock Purchase Right per share of common stock (the Rights) and each such Right has an exercise price of \$23.00. The Rights become exercisable, unless redeemed by the Company, upon the occurrence of certain events, including the announcement of a tender offer or exchange offer for our common stock or the acquisition of a specified percentage of the our common stock by a third party.





Table of Contents

## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2010, 2009 and 2008

**11 SHARE-BASED COMPENSATION**

**Share-Based Compensation Expense** We account for share-based compensation in accordance with ASC Topic 718, *Compensation Stock Compensation*. Share-based compensation was recognized as follows in the consolidated statement of operations, (in thousands, except per share):

	2010	December 31, 2009	2008
Cost of revenue	\$ 177	\$ 331	\$ 333
Marketing and sales	1,432	1,103	707
Research and development	425	314	321
General and administrative	3,365	2,512	1,634
<b>Total expense</b>	<b>5,399</b>	<b>4,260</b>	<b>2,995</b>
Income tax effect	(1,776)	(1,423)	(1,100)
<b>Decrease in net income</b>	<b>\$ 3,623</b>	<b>\$ 2,837</b>	<b>\$ 1,895</b>

As of December 31, 2010, unrecognized compensation related to the unvested portion of our stock options and other stock awards was approximately \$8.5 million, which is expected to be recognized over a weighted average period of 2.6 years.

**Stock Awards Plans** Our Amended and Restated 2000 Stock Awards Plan (the "Plan") provides for the granting of the following:

Incentive stock options to employees;

Non-statutory stock options to employees, directors and consultants;

Restricted stock awards and restricted stock units;

Stock bonuses; and

Stock appreciation rights.

As of December 31, 2010, there were 2,857,888 shares available for future awards under the Restated Plan.

Under the Plan, stock options may be issued at not less than the fair market value of the common stock on the date of grant, as determined by the Board of Directors. Options issued under the Plan become exercisable as determined by the Board of Directors and expire no more than six years after the date of grant. Most options vest ratably over four years. Since 2005, our option awards have consisted solely of non-statutory stock

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

options. Stock awards are typically granted to existing employees once a year at the time of the Company's annual shareholder meeting.

We also provide for grants of options to our nonemployee directors from the 2000 Director Stock Option Plan (the Director Plan) that have similar terms to those options granted from the Plan, except that such options vest ratably over a twelve month period. As of December 31, 2010 there were 511,142 shares available for future awards under the Director Plan.

We also have the 1991 Stock Option Plan and the 2000 Supplemental Stock Option Plan (the Inactive Plans) that have been closed to new grants since July 20, 2001. Options outstanding under the Inactive Plans were generally governed by the same terms as those under the 2000 Plan, except that the options expired no more than ten years after the date of grant. Options still outstanding under the Inactive Plans remain outstanding pursuant to their original terms.

F-21

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

**Stock Option Activity** Stock option activity under our stock awards plans for the year ended December 31, 2010 is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 2008 (2,134,604 shares exercisable at a weighted average exercise price of \$7.76 per share)	2,876,072	\$ 9.97
Granted (weighted average fair value of \$3.67 per share)	676,600	\$ 10.71
Exercised	(34,224)	\$ 10.16
Cancelled	(83,054)	\$ 14.90
Outstanding, December 31, 2009 (2,494,821 shares exercisable at a weighted average exercise price of \$8.70 per share)	3,435,394	\$ 10.00
Granted (weighted average fair value of \$5.49 per share)	484,100	\$ 16.48
Exercised	(222,038)	\$ 7.44
Cancelled	(58,499)	\$ 14.75
Outstanding, December 31, 2010 (2,683,816 shares exercisable at a weighted average exercise price of \$9.66 per share)	3,638,957	\$ 10.94

The following table summarizes information concerning outstanding and exercisable options outstanding at December 31, 2010:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding as of 12/31/10	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Exercisable as of 12/31/10	Weighted Average Exercise Price
\$3.15 - \$4.07	582,334	\$ 3.81	2.72	582,334	\$ 3.81
\$4.11 - \$5.69	372,830	\$ 4.49	2.84	372,830	\$ 4.49
\$ 5.77 - \$8.51	138,330	\$ 7.08	3.73	130,205	\$ 7.02
\$10.03 - \$10.03	426,750	\$ 10.03	4.44	426,750	\$ 10.03
\$10.73 - \$10.73	591,233	\$ 10.73	4.33	227,858	\$ 10.73
\$10.78 - \$12.98	387,904	\$ 11.51	1.95	343,773	\$ 11.37
\$13.16 - \$16.15	347,601	\$ 15.69	2.87	298,963	\$ 15.73
\$16.78 - \$16.78	433,100	\$ 16.78	5.30	63,520	\$ 16.78
\$16.89 - \$18.74	40,500	\$ 17.91	3.24	29,416	\$ 17.96
\$20.09 - \$20.09	318,375	\$ 20.09	3.33	208,167	\$ 20.09
\$3.15 - \$20.09	3,638,957	\$ 10.94	3.53	2,683,816	\$ 9.66

The intrinsic value of options exercised, representing the difference between the closing stock price of Company's common stock on the date of the exercise and the exercise price, in the years ended December 31, 2010, 2009 and 2008, was \$1.5 million, \$165,000, and \$2.0 million,

respectively.

As of December 31, 2010, there were: (i) 3,501,443 options vested and expected to vest with a weighted average exercise price of \$10.80, an intrinsic value of \$15.8 million, and a weighted average remaining contractual term of 3.5 years; and (ii) 2,683,816 options exercisable with a weighted average exercise price of \$9.66, an intrinsic value of \$14.5 million, and a weighted average remaining contractual term of 3.2 years.

F-22

Table of Contents

## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Years Ended December 31, 2010, 2009 and 2008

Cash received from option exercises for the years ended December 31, 2010 and 2009 was \$1.7 million and \$348,000, respectively.

**Black-Scholes Inputs** The fair value of option grants was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	Years Ended December 31,		
	2010	2009	2008
Expected life in years	4.2	4.2	4.2
Risk free interest rate	1.5%	2.2%	2.8%
Expected volatility	38%	40%	37%
Expected forfeiture rate	11.5%	13.2%	13.4%
Dividend yield	None	None	None

We have no history or expectation of paying dividends on our common stock. All options are treated as a single group in the determination of expected life, as we do not currently expect substantially different exercise or post-vesting termination behavior among our employee population. Prior to June 2006 we granted options that had a contractual term of 10 years. Subsequent to June 15, 2006, all options granted by the Company have a contractual life of six years. Through December 31, 2007 we used the simplified method allowed under Staff Accounting Bulletin No. 107 in determining the expected life of options. Beginning January 1, 2008 we adopted a method of determining the expected life of options based exclusively on historical share option exercise experience of our employees for options granted by the Company after June 15, 2006.

The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant. Expected volatility is based exclusively on historical volatility data of our common stock.

Share-based compensation expense associated with options is based on awards ultimately expected to vest. At the time of an option grant, we estimate the expected future rate of forfeitures based on historical experience. These estimates are revised, if necessary, in subsequent periods if actual forfeiture rates differ from those estimates. If the actual forfeiture rate is lower than estimated we will record additional expense and if the actual forfeiture is higher than estimated we will record a recovery of prior expense.

**Restricted Stock Awards Activity** The following table summarizes the activity for restricted stock awards during the years ended December 31, 2010 and 2009:

	Shares	Weighted
		Average Grant Date Fair Value
Unvested at December 31, 2008	338,518	\$ 17.50
Forfeited	(16,800)	\$ 16.77
Vested	(88,634)	\$ 16.06
Granted	314,700	\$ 10.71
Unvested at December 31, 2009	547,784	\$ 13.87
Forfeited	(4,250)	\$ 13.34
Vested	(165,584)	\$ 15.96
Granted	212,100	\$ 16.68

Unvested at December 31, 2010	590,050	\$	14.30
-------------------------------	---------	----	-------

F-23

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

The fair market value of outstanding restricted stock awards at December 31, 2010 was \$8.5 million. The weighted average remaining recognition period for unvested restricted stock awards at December 31, 2010 was 2.6 years.

**Restricted Stock Units Activity** The following table summarizes restricted stock units activity for the years ended December 31, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
Beginning outstanding balance	66,500	35,500
Awarded	32,450	51,100
Released	(8,750)	(8,500)
Forfeited	(18,900)	(11,600)
Ending outstanding balance	71,300	66,500

The aggregate intrinsic value of outstanding restricted stock units at December 31, 2010 was \$1.0 million. The weighted average remaining recognition period for unvested restricted stock units at December 31, 2010 was 2.9 years.

**Employee Stock Purchase Plan** The 2000 Employee Stock Purchase Plan (the "ESPP") was adopted effective upon the closing of our initial public offering. Under the ESPP, eligible employees can elect to have salary withholdings of up to 15% of the sum of their W-2 cash compensation and 401(k) contributions to a maximum of \$12,500 per offering period, to purchase shares of common stock on April 30 and October 31 of each year. The purchase price for shares acquired under the ESPP is 85% of the fair market value on the last day of the offering period. As of December 31, 2010, there were 4,212,387 shares reserved for future issuance under the ESPP.

Because the ESPP does not have a "look back" feature, the compensation expense associated with the Plan is not measured by the use of the Black-Scholes pricing model, but rather by measuring the difference between the fair market value of our common stock on the last day of the offering period and the purchase price for the offering period, which is 85% of the fair market value. Compensation expense associated with the ESPP for the years ended December 31, 2010, 2009 and 2008, respectively, was \$133,000, \$108,000 and \$87,000.

Cash received from purchases under the ESPP for the years ended December 31, 2010, 2009 and 2008, respectively, was approximately \$866,000, \$729,000 and \$548,000.

**12 RESTRUCTURING RESERVE**

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

The Restructuring Plan resulted in a staff reduction of approximately 70 employees for which we recorded a restructuring charge for severance benefits of approximately \$3.0 million during the first fiscal quarter of 2010, which was reduced by \$268,000 during the second fiscal quarter. In addition, during the second fiscal quarter of 2010 we recorded a \$300,000 charge for a lease termination fee. We also recorded a \$44,000 charge to write off property and equipment.



Table of Contents

## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Years Ended December 31, 2010, 2009 and 2008

We account for restructuring costs in accordance with ASC Topic 420, *Exit or Disposal Cost Obligations*. The balance of the reserve is included in accrued liabilities on the accompanying balance sheets. Substantially all of the costs associated with the Restructuring Plan will result in cash expenditures.

Detail of activity in the restructuring reserve is as follows, (in thousands):

	Balance January 1, 2010	Charged To Expense	Accrual Reversal	Amounts Paid	Balance December 31, 2010
Employee termination benefits	\$	\$ 3,030	\$ (268)	\$ (2,675)	\$ 87
Lease termination fee		300		(300)	
Totals	\$	\$ 3,330	\$ (268)	\$ (2,975)	\$ 87

In addition to the above charges, during 2010 we incurred approximately \$131,000 of other costs directly associated with the Restructuring Plan that did not qualify for accrual and reporting under ASC Topic 420 and were charged to expense as incurred.

**13 OTHER INCOME (EXPENSE), NET**

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

	Years Ended December 31,		
	2010	2009	2008
Investment income	\$ 36	\$ 228	\$ 1,029
Interest expense	(128)	(153)	(735)
Foreign currency exchange gain (loss)	(521)	520	1,620
Change in fair value of contingent obligation		600	
Other	495	555	228
Total other income (expense), net	\$ (118)	\$ 1,750	\$ 2,142

**14 INCOME TAXES**

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We record net deferred tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations. In the event we were to determine that we would be able to realize our deferred income tax assets in the future in excess of their net recorded amount, we would make an adjustment to the valuation allowance which

would reduce the provision for income taxes.

F-25

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

The components of our income tax expense for the years ended December 31, 2010, 2009 and 2008 consisted of the following (in thousands):

	<b>Years Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Current</b>			
U.S. Federal	\$ 1,997	\$ 3,284	\$ 4,322
U.S. State and local	779	543	(150)
Non-U.S.	1,366	640	1,647
<b>Total current tax expense</b>	<b>4,142</b>	<b>4,467</b>	<b>5,819</b>
<b>Deferred</b>			
U.S. Federal	(574)	(896)	1,430
U.S. State and local	(89)	(141)	294
Non-U.S.	2,315	2,271	2,490
<b>Total deferred tax benefit</b>	<b>1,652</b>	<b>1,234</b>	<b>4,214</b>
<b>Total income tax expense</b>	<b>\$ 5,794</b>	<b>\$ 5,701</b>	<b>\$ 10,033</b>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets and liabilities as of December 31, 2010 and 2009 are as follows (in thousands):

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Deferred tax assets:</b>		
Net operating loss carryforwards	\$ 6,016	\$ 6,769
Credit carryforwards	3,966	3,297
Accruals deductible in different periods	8,414	9,001
Basis difference in fixed and intangible assets	285	285
Employee benefits	2,838	1,012
<b>Total deferred tax assets</b>	<b>21,234</b>	<b>20,364</b>
Valuation allowance	(5,739)	(5,768)
<b>Total net deferred tax assets</b>	<b>\$ 15,495</b>	<b>\$ 14,596</b>
<b>Deferred tax liabilities:</b>		
Dividends from foreign subsidiaries	\$ (369)	\$ (369)
Basis difference in fixed and intangible assets	(18,479)	(14,255)
<b>Total deferred tax liabilities</b>	<b>(18,848)</b>	<b>(14,624)</b>

Edgar Filing: NATUS MEDICAL INC - Form 10-K

Total net deferred tax assets (liabilities)	\$ (3,353)	\$ (28)
---	------------	---------

F-26

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

The amount of income tax recorded by us differs from the amount using the federal statutory rate of 34% for 2010 and 35% for 2009 and 2008, respectively, as follows (in thousands):

	Years Ended December 31,		
	2010	2009	2008
Federal statutory tax expense	\$ 6,022	\$ 5,979	\$ 9,560
State tax expense	532	299	494
Difference in US and foreign rates	(875)	(473)	(354)
Stock compensation expense on incentive stock options	123	176	138
Valuation allowance			838
Other	(8)	(280)	(643)
<b>Total expense</b>	<b>\$ 5,794</b>	<b>\$ 5,701</b>	<b>\$ 10,033</b>

At December 31, 2010 we had total U.S. federal net operating loss carryforwards of approximately \$4.6 million and state net operating loss carryforwards of approximately \$2.0 million, available to reduce future taxable income. The federal and state net operating loss carryforwards, if not utilized to offset taxable income in future periods, will expire in various amounts beginning in 2021 and 2015, respectively.

At December 31, 2010, we had foreign net operating losses of \$3.7 million and \$8.1 million from Deltamed and Alpine Biomed, respectively. Alpine Biomed's net operating loss carryforwards, if not utilized to offset taxable income in future periods, will expire in various amounts beginning in 2028. In addition, Alpine has investment tax credits of approximately \$147,000 which will expire in various amounts beginning in 2022. At December 31, 2010, Xltek has investment tax credits of approximately \$549,000 which will expire in various amounts beginning in 2012.

The extent to which the federal operating loss and tax credit carryforwards can be used to offset future taxable income may be limited, depending on the extent of ownership changes within any three-year period, as provided in the Tax Reform Act of 1986. Such a limitation could result in the expiration of carryforwards before they are utilized.

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Accordingly, valuation allowances of \$5.7 million and \$5.8 million were recorded during the years ended December 31, 2010 and 2009, respectively.

We receive tax deductions from the gains realized by employees on the exercise of certain non-qualified stock options for which the benefit is recognized as a component of stockholders' equity. In 2010 we recorded approximately \$551,000 of additional paid in capital related to exercises of non-qualified stock options by employees.

We have not provided for U.S. federal income and foreign withholding taxes on undistributed earnings from non-U.S. operations as of December 31, 2010 because such earnings are intended to be reinvested indefinitely. As of December 31, 2010, the amount of undistributed earnings from non-U.S. operations has not been estimated as the determination is not practicable.

**Uncertain Tax Positions** We account for uncertain tax positions in accordance with ASC 740-10-05, *Accounting for Income Taxes* an interpretation of FASB Statement 109. This interpretation establishes the criteria that must be met prior to recognition of the financial statement benefit of a position taken in a tax return



**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

and is based on a benefit-recognition model. Provided that the tax position is deemed more likely than not of being sustained, we recognize the largest amount of tax benefit that is greater than 50 percent likely of being ultimately realized upon settlement. The tax position is derecognized when it is no longer more likely than not of being sustained.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (excluding interest and penalties) is as follows (in thousands):

Balance at January 1, 2008	\$ 3,300
Additions for tax positions related to the current year	1,046
Lapse of statutes of limitations	(17)
Balance at January 1, 2009	4,329
Additions for tax positions related to the current year	1,109
Lapse of statutes of limitations	(48)
Balance at January 1, 2010	5,390
Additions for tax positions related to the current year	241
Lapse of statutes of limitations	(145)
Balance at December 31, 2010	\$ 5,486

The unrecognized tax benefits of \$5.5 million include \$2.5 million of uncertain tax positions that would impact our effective tax rate if recognized.

At December 31, 2010 and 2009, we had cumulatively accrued approximately \$932,000 and \$647,000 for estimated interest and penalties related to uncertain tax positions. We record interest and penalties related to unrecognized tax positions as a component of income tax expense, which totaled approximately \$285,000 and \$161,000 for the 12 months ended December 31, 2009 and 2008, respectively.

We are currently unaware of any uncertain tax positions that could result in significant additional payments, accruals, or other material deviation in this estimate over the next 12 months.

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

**15 EMPLOYEE BENEFIT PLAN**

We have a 401(k) tax-deferred savings plan under which eligible U.S. employees may elect to have a portion of their salary deferred and contributed to the plan. Employer matching contributions are determined by management and are discretionary. Employer matching contributions were approximately \$492,000, \$455,000 and \$467,000, respectively, in the years ended December 31, 2010, 2009, and 2008. For new hires, employer contributions vest ratably over the first two years of employment.

**16 SEGMENT, CUSTOMER, AND GEOGRAPHIC INFORMATION**

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





**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

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

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

	Years Ended December 31,		
	2010	2009	2008
<b>Revenue:</b>			
United States	\$ 126,680	\$ 109,721	\$ 112,589
Foreign countries	91,975	56,704	49,242
	\$ 218,655	\$ 166,425	\$ 161,831
<b>Long-lived assets:</b>			
United States	\$ 7,852	\$ 6,297	\$ 7,579
Foreign countries	15,546	7,769	6,423
	\$ 23,408	\$ 14,066	\$ 14,002

Long-lived assets consist principally of property and equipment (net). During the years ended December 31, 2010, 2009 and 2008, no single customer or foreign country contributed to more than 10% of revenue, and revenue from services was less than 10% of revenue.

During the years ended December 31, 2010, 2009 and 2008, respectively, revenue from devices and systems was \$134.8 million, \$96.2 million and \$102.5 million, while revenue from supplies and services was \$80.1 million, \$67.1 million and \$56.7 million, respectively.

**17 DEBT AND CREDIT ARRANGEMENTS**

Long-term borrowings are composed of the following (2010 and 2009 columns in thousands):

	December 31,	
	2010	2009
Term loan \$2.9 million Canadian ( CAD ), interest at cost of funds plus 2.5%, due September 15, 2014 with principle repayable in monthly installments of \$16,000 until August 15, 2014, and one final payment of \$404,000 collateralized by a first lien on the land and building owned by Xltek	\$ 893	\$ 1,062
Term loan CAD \$300,000, interest at cost of funds plus 2.5%, due November 15, 2010 with principle repayable in monthly installments of \$2,000 until October 10, 2010 and one final payment of \$36,000 collateralized by various assets of Xltek		47
<b>Total long-term debt (including current portion)</b>	<b>893</b>	<b>1,109</b>
Less: current portion of long-term debt	(156)	(178)
<b>Total long-term debt</b>	<b>\$ 737</b>	<b>\$ 931</b>

## Edgar Filing: NATUS MEDICAL INC - Form 10-K

We have a \$50 million revolving credit facility with Wells Fargo Bank, National Association ( Wells Fargo ). The revolving credit facility contains covenants, including covenants relating to liquidity and other

F-29

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in all of the assets of the Company. The credit facility contains covenants including minimum EBITDA, quick ratio, and a leverage ratio. We did not draw on the facility during 2010. We have no other significant credit facilities.

**18 COMMITMENTS AND CONTINGENCIES**

**Leases** We have entered into noncancelable operating leases for some of our facilities located in the U.S. and Europe through October 2016. Minimum lease payments under noncancelable operating leases as of December 31, 2010 are as follows (in thousands):

Year Ending December 31,	Operating Leases
2011	\$ 1,795
2012	938
2013	818
2014	744
2015	696
Thereafter	92
Total minimum lease payments	\$ 5,083

Rent expense, which is recorded on the straight-line method from commencement over the period of the lease, totaled \$1,971,000, \$2,140,000 and \$1,805,000 in 2010, 2009 and 2008, respectively.

**Purchase commitments** We had various firm purchase commitments for inventory totaling \$15.7 million at December 31, 2010.

**Indemnifications** Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. We have a director and officer liability insurance policy that limits our exposure under these indemnifications and enables us to recover a portion of any future loss arising out of them. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. We have determined that these agreements fall within the scope of ASC 460, *Guarantees*. In some cases we have obtained liability insurance providing coverage that limits its exposure for these other indemnified matters. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these indemnification agreements is minimal and have not recorded a liability for these agreements as of December 31, 2010.

**Legal matters** We may from time to time become a party to various legal proceedings or claims that arise in the ordinary course of business. We do not believe that any current legal or administrative proceedings are likely to have a materially adverse effect on our business, financial condition, or results of operations.

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008****19 FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

	Fair Value as of 12/31/10	Fair Value Measurements as of 12/31/10 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 3,146		\$ 3,146	
Fixed rate term deposits	1,005		1,005	
<b>Total</b>	<b>\$ 4,151</b>		<b>\$ 4,151</b>	

	Fair Value as of 12/31/09	Fair Value Measurements as of 12/31/09 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 3,142		\$ 3,142	
Fixed rate term deposits	965		965	
<b>Total</b>	<b>\$ 4,107</b>		<b>\$ 4,107</b>	

In accordance with ASC Topic 820, *Fair Value Measurements and Disclosures*, Level 1 evaluations are based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 valuations are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Bank money market accounts have a net asset value of \$1.00 per share and consist principally of commercial paper with a rating of A-1/A-1+. Level 3 valuations are based on inputs that are not observable and significant to the overall fair value measurement.

**20 IMMATERIAL CORRECTIONS TO PRIOR PERIOD FINANCIAL STATEMENTS**

Subsequent to the issuance of our consolidated financial statements for the year ended December 31, 2009 we discovered certain errors relating primarily to the amount of manufacturing labor and overhead applied to inventory. As a result, certain previously reported amounts included in the accompanying consolidated financial statements have been restated to reflect the correction of the errors. We believe the effects of the errors are not material to our consolidated financial statements. In addition, certain other corrections previously identified that are not material individually or in the aggregate have also been corrected related to accrued sales commissions, the amount of revenue deferred under multiple deliverable revenue arrangements, and reclassification from accrued liabilities to accounts payable.

**Table of Contents****NATUS MEDICAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2010, 2009 and 2008**

A summary of the effects of the correction of these errors on our consolidated financial statements as of and for the years ended December 31, 2009 and 2008 are presented in the table below (in thousands, except per share data):

	2009	
	As Previously Reported	As Corrected
<b>Balance Sheet</b>		
Inventories	\$ 22,408	\$ 23,089
Prepaid expenses	4,213	3,825
Deferred income tax	4,248	4,166
Total current assets	108,170	108,381
Other assets	6,853	7,241
Total assets	291,491	292,090
Accounts payable	11,074	13,982
Accrued liabilities	17,245	14,513
Deferred revenue	4,705	4,501
Total current liabilities	33,202	33,174
Other liabilities	7,186	7,575
Deferred income tax	7,016	6,853
Total liabilities	48,335	48,533
Retained earnings	5,737	6,138
Total liabilities and stockholders' equity	291,491	292,090

	2009		2008	
	As Previously Reported	As Corrected	As Previously Reported	As Corrected
<b>Statements of Operations</b>				
Revenue	\$ 166,505	\$ 166,425	\$ 161,831	\$ 161,831
Cost of revenue	66,670	66,077	60,933	61,332
Gross profit	99,835	100,348	100,898	100,499
Income from operations	14,817	15,333	25,483	25,173
Income before provision for income tax	16,567	17,083	27,625	27,315
Net income	11,079	11,382	17,473	17,282
Net income per share, diluted	\$ 0.39	\$ 0.40	\$ 0.66	\$ 0.65
<b>Statements of Cash Flows</b>				
Net income	\$ 11,079	\$ 11,382	\$ 17,473	\$ 17,282
Share based compensation	3,980	4,260	3,275	2,995
Change in operating assets and liabilities, net of assets and liabilities acquired in acquisitions:				
Accounts receivable	(78)	683	(7,575)	(8,336)
Inventories	740	25	(2,726)	(2,296)
Other assets	727	(34)	973	1,734
Accrued liabilities	(142)	380	(2,698)	(2,657)
Deferred revenue	237	(153)		

Edgar Filing: NATUS MEDICAL INC - Form 10-K

Net cash provided by operating activities	26,588	26,588	11,802	11,802
<b>Retained Earnings (Accumulated Deficit)</b>				
Beginning of year	\$ (5,342)	\$ (5,244)	\$ (22,815)	\$ (22,526)
End of year	5,737	6,138	(5,342)	(5,244)

F-32

**Table of Contents****EXHIBIT INDEX**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		File Date
			Exhibit No.	File No.	
2.1	Share Purchase Agreement dated October 12, 2010 by and between Natus Medical Incorporated, and Medix I.C.S.A.				
3.1	Natus Medical Incorporated Amended and Restated Certificate of Incorporation	S-1	3.1.1	333-44138	08/18/2000
3.2	Natus Medical Incorporated Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	8-A	3.1.2	000-33001	09/06/2002
3.3	Bylaws of Natus Medical Incorporated	8-K	3.1	000-33001	06/18/2008
4.1	Amended and Restated Preferred Stock Rights Agreement, dated as of October 8, 2002, between Natus Medical Incorporated and Equiserve Trust Company, N.A., including the form of Rights Certificate and Summary of Rights attached thereto as Exhibits B and C, respectively	8-A	4.1	000-33001	10/08/2002
4.2	Amendment No. 1 to the Amended and Restated Preferred Stock Rights Agreement dated as of February 14, 2003 between Natus Medical Incorporated and Equiserve Trust Company, N.A.	8-A	4.2	000-33001	02/25/2003
4.3	Amendment No. 2 to the Amended and Restated Preferred Stock Rights Agreement dated as of March 15, 2005 between Natus Medical Incorporated and Equiserve Trust Company, N.A.	8-K	99.1	000-33001	03/15/2005
4.4	Amendment No. 3 to the Amended and Restated Preferred Stock Rights Agreement dated as of August 17, 2006 between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	99.01	000-33001	08/17/2006
4.5	Registration Rights Agreement dated as of April 9, 2008 by and among Natus Medical Incorporated and D3 Family Funds	8-K	4.01	000-33001	04/09/2008
10.1	Form of Indemnification Agreement between Natus Medical Incorporated and each of its directors and officers	S-1	10.1	333-44138	08/18/2000
10.2*	Natus Medical Incorporated Amended and Restated 1991 Stock Option Plan	S-1	10.2	333-44138	08/18/2000
10.2.1*	Form of Option Agreement under the Amended and Restated 1991 Stock Option Plan	S-1	10.2.1	333-44138	08/18/2000
10.3*	Natus Medical Incorporated Amended and Restated 2000 Stock Awards Plan	8-K	10.1	000-33001	01/04/2006
10.3.1*	Form of Option Agreement under the Amended and Restated 2000 Stock Awards Plan	S-1	10.3.1	333-44138	08/18/2000

**Table of Contents**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		File Date
			Exhibit No.	File No.	
10.3.2*	Form of Restricted Stock Purchase Agreement under the Amended and Restated 2000 Stock Awards Plan	10-Q	10.2	000-33001	08/09/2006
10.3.3*	Form of Restricted Stock Unit Agreement under the Amended and Restated 2000 Stock Awards Plan	10-K	10.3.3	000-33001	03/14/2008
10.4*	Natus Medical Incorporated 2000 Director Option Plan	10-Q	10.02	000-33001	05/09/2008
10.4.1*	Form of Option Agreement under the 2000 Director Option Plan	S-1	10.4.1	333-44138	08/18/2000
10.5*	Natus Medical Incorporated 2000 Employee Stock Purchase Plan and form of subscription agreement thereunder	8-K	10.2	000-33001	01/04/2006
10.6	Lease Agreement dated August 24, 1998 between Natus Medical Incorporated and San Carlos Co-Tenancy	S-1	10.8	333-44138	08/18/2000
10.7	Amendment to Lease Agreement dated August 24, 1998 between Natus Medical Incorporated and San Carlos Co-Tenancy	10-K	10.8.1	000-33001	03/27/2003
10.8	6th Amendment to Lease Agreement dated July 1, 2005 between Natus Medical Incorporated and San Carlos Co-Tenancy	10-K	10.10	000-33001	03/16/2006
10.9*	Natus Medical Incorporated 2000 Supplemental Stock Option Plan	S-1	10.15	333-44138	08/18/2000
10.9.1*	Form of Option Agreement for 2000 Supplemental Stock Option Plan	S-1	10.15.1	333-44138	08/18/2000
10.10*	Form of Employment Agreement between Natus Medical Incorporated and each of its executive officers	10-K	10.1	000-33001	03/10/2009
10.11*	Amended Employment Agreement between Natus Medical Incorporated and James B. Hawkins dated April 25, 2008	8-K	99.1	000-33001	04/29/2008
10.12	Amended and Restated Credit Agreement dated November 28, 2007 by and between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	12/03/2007
10.13	Security Agreement dated November 28, 2007 by Natus Medical Incorporated in favor of Wells Fargo Bank, National Association	8-K	10.2	000-33001	12/03/2007
10.14	First Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	08/06/2008



**Table of Contents**

Exhibit No.	Exhibit	Filing	Incorporated By Reference		File Date
			Exhibit No.	File No.	
10.15	Second Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	09/05/2008
10.16	Third Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-K	10.16	000-33001	03/10/2009
10.17	Amended and Restated Security Agreement dated February 19, 2009 in favor of Wells Fargo Bank, National Association	10-K	10.17	000-33001	03/10/2009
10.18	Fourth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	08/07/2009
10.19	Fifth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	09/11/2009
10.20	Sixth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-Q	10.1	000-33001	11/23/2009
10.21	Seventh Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank, National Association	10-K	10.21	000-33001	03/15/2010
10.22	Second Amended and Restated Credit Agreement dated as of April 22, 2010 between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	04/27/2010
21.1	Subsidiaries of the Registrant				
23.1	Consent of Independent Registered Public Accounting Firm				
24.1	Power of Attorney				
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				

\* Indicates a management contract or compensatory plan or arrangement