

NUVASIVE INC  
Form 10-Q  
October 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-50744

NUVASIVE, INC.

(Exact name of registrant as specified in its charter)

Delaware 33-0768598  
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

7475 Lusk Boulevard

San Diego, CA 92121

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(Address of principal executive offices)

(858) 909-1800

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

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

As of October 20, 2016 there were 50,348,204 shares of the registrant's common stock (par value \$0.001 per share) outstanding.

Table of Contents

NuVasive, Inc.

Quarterly Report on Form 10-Q

September 30, 2016

PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	3
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Operations</u>	4
	<u>Consolidated Statements of Comprehensive Income</u>	5
	<u>Consolidated Statements of Cash Flows</u>	6
	<u>Notes to Unaudited Consolidated Financial Statements</u>	7
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	41
Item 4.	<u>Controls and Procedures</u>	41

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	42
Item 1A.	<u>Risk Factors</u>	42
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3.	<u>Defaults Upon Senior Securities</u>	42
Item 4.	<u>Mine Safety Disclosures</u>	42
Item 5.	<u>Other Information</u>	42
Item 6.	<u>Exhibits</u>	43

	<u>SIGNATURES</u>	44
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Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

NUVASIVE, INC.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except par values and share amounts)

	September 30, 2016	December 31, 2015
<b>ASSETS</b>	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 203,818	\$ 192,339
Short-term marketable securities	—	165,423
Accounts receivable, net of allowances of \$8,335 and \$5,320, respectively	143,818	127,595
Inventory, net	212,784	168,140
Prepaid income taxes	46,904	40,540
Prepaid expenses and other current assets	9,573	8,790
Total current assets	616,897	702,827
Property and equipment, net	179,913	141,441
Long-term marketable securities	—	112,332
Intangible assets, net	303,928	85,076
Goodwill	498,686	154,281
Deferred tax assets	4,633	83,691
Restricted cash and investments	7,420	5,615
Other assets	24,568	17,404
Total assets	\$ 1,636,045	\$ 1,302,667
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 72,581	\$ 60,985
Contingent consideration liabilities	45,005	—
Accrued payroll and related expenses	41,010	37,641
Income tax liabilities	828	990
Short-term senior convertible notes	120,975	—
Total current liabilities	280,399	99,616
Long term senior convertible notes	559,950	372,920
Deferred and income tax liabilities, non-current	26,239	8,602
Non-current litigation liabilities	—	88,261
Other long-term liabilities	46,643	14,425
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized, none outstanding	—	—
	55	53

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Common stock, \$0.001 par value; 120,000,000 shares authorized at September 30, 2016 and December 31, 2015, 55,096,226 and 52,616,471 issued and outstanding at September 30, 2016 and December 31, 2015, respectively		
Additional paid-in capital	1,033,298	989,387
Accumulated other comprehensive loss	(5,891 )	(12,112 )
Accumulated deficit	(73,235 )	(104,006 )
Treasury stock at cost; 4,751,464 shares and 3,316,794 shares at September 30, 2016 and December 31, 2015, respectively	(237,411 )	(161,788 )
Total NuVasive, Inc. stockholders' equity	716,816	711,534
Non-controlling interests	5,998	7,309
Total equity	722,814	718,843
Total liabilities and equity	\$1,636,045	\$1,302,667

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

NUVASIVE, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenue	\$239,649	\$200,538	\$690,963	\$595,831
Cost of goods sold (excluding below amortization of intangible assets)	59,196	49,167	173,167	143,246
Gross profit	180,453	151,371	517,796	452,585
Operating expenses:				
Sales, marketing and administrative	131,886	110,554	391,211	338,444
Research and development	12,516	9,189	35,016	27,227
Amortization of intangible assets	11,438	3,067	29,912	9,037
Litigation liability (gain)	—	(500 )	(43,310 )	(42,507 )
Business transition costs	3,451	950	11,514	10,845
Total operating expenses	159,291	123,260	424,343	343,046
Interest and other expense, net:				
Interest income	190	362	924	1,125
Interest expense	(10,979 )	(7,307 )	(29,988 )	(21,675 )
Loss on repurchases of convertible notes	—	—	(17,444 )	—
Other income (expense), net	94	387	(102 )	530
Total interest and other expense, net	(10,695 )	(6,558 )	(46,610 )	(20,020 )
Income before income taxes	10,467	21,553	46,843	89,519
Income tax expense	(6,972 )	(8,803 )	(17,383 )	(35,332 )
Consolidated net income	\$3,495	\$12,750	\$29,460	\$54,187
Add back net loss attributable to non-controlling interests	\$(431 )	\$(210 )	\$(1,311 )	\$(601 )
Net income attributable to NuVasive, Inc.	\$3,926	\$12,960	\$30,771	\$54,788
Net income per share attributable to NuVasive, Inc.:				
Basic	\$0.08	\$0.26	\$0.62	\$1.13
Diluted	\$0.07	\$0.24	\$0.58	\$1.05
Weighted average shares outstanding:				
Basic	50,264	48,993	49,970	48,513
Diluted	55,782	53,199	53,498	52,202

See accompanying Notes to Unaudited Consolidated Financial Statements.



Table of Contents

NUVASIVE, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months		Nine Months	
	Ended September		Ended September	
(unaudited)	30,	30,	30,	30,
	2016	2015	2016	2015
Consolidated net income	\$3,495	\$12,750	\$29,460	\$54,187
Other comprehensive income (loss):				
Unrealized (loss) gain on marketable securities, net of tax	(10 )	57	332	201
Translation adjustments, net of tax	470	(410 )	5,889	(1,854 )
Other comprehensive income (loss)	460	(353 )	6,221	(1,653 )
Total consolidated comprehensive income	3,955	12,397	35,681	52,534
Net loss attributable to non-controlling interests	(431 )	(210 )	(1,311 )	(601 )
Comprehensive income attributable to NuVasive, Inc.	\$4,386	\$12,607	\$36,992	\$53,135

See accompanying Notes to Unaudited Consolidated Financial Statements.



Table of Contents

NUVASIVE, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)	Nine Months Ended September 30,	
	2016	2015
<b>Operating activities:</b>		
Consolidated net income	\$29,460	\$54,187
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	73,765	49,006
Loss on repurchases of convertible notes	17,444	—
Amortization of non-cash interest	16,906	13,255
Stock-based compensation	19,645	20,570
Reserves on current assets	9,027	7,232
Other non-cash adjustments	11,369	13,127
Deferred income taxes	24,810	37,047
<b>Changes in operating assets and liabilities, net of effects from acquisitions:</b>		
Accounts receivable	(3,038 )	2,163
Inventory	(22,423 )	(19,768 )
Prepaid expenses and other current assets	(3,457 )	2,512
Accounts payable and accrued liabilities	5,939	8,828
Accrued royalties	(85 )	(46,999 )
Accrued payroll and related expenses	(1,670 )	(5,080 )
Litigation liability	(88,450 )	(35,333 )
Income taxes	6,778	(52,739 )
Net cash provided by operating activities	96,020	48,008
<b>Investing activities:</b>		
Acquisition of Ellipse Technologies, net of cash acquired	(380,080)	—
Other acquisitions and investments	(108,150)	(1,357 )
Purchases of intangible assets	(5,918 )	(28,589 )
Proceeds from sales of property and equipment	—	40
Purchases of property and equipment	(73,882 )	(59,905 )
Purchases of marketable securities	(128,956)	(320,177)
Proceeds from sales of marketable securities	407,032	272,666
Sales of restricted investments	—	180,694
Purchases of restricted investments	—	(62,625 )
Net cash used in investing activities	(289,954)	(19,253 )
<b>Financing activities:</b>		
Incremental tax benefits related to stock-based compensation awards	—	15,185
Proceeds from the issuance of common stock	6,668	9,040
Payment of contingent consideration	—	(514 )
Purchase of treasury stock	(24,441 )	(52,532 )

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Proceeds from issuance of convertible debt, net of issuance costs	634,140	—
Proceeds from sale of warrants	44,850	—
Purchase of convertible note hedge	(111,150)	—
Repurchases of convertible notes	(343,835)	—
Proceeds from revolving line of credit	50,000	—
Repayments on revolving line of credit	(50,000 )	—
Other financing activities	(1,701 )	(131 )
Net cash provided by (used in) financing activities	204,531	(28,952 )
Effect of exchange rate changes on cash	882	(862 )
Increase (decrease) in cash and cash equivalents	11,479	(1,059 )
Cash and cash equivalents at beginning of period	192,339	142,387
Cash and cash equivalents at end of period	\$203,818	\$141,328

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Description of Business

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

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

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

On July 1, 2016, the Company acquired BNN Holdings Corp., which through its subsidiaries and affiliates, owns and operates Biotronic NeuroNetwork, a patient-centric healthcare organization that provides intraoperative neurophysiological monitoring services to surgeons and healthcare facilities across the U.S. The Company combined the service offerings of Biotronic NeuroNetwork with its Impulse Monitoring, Inc. business under the newly created division NuVasive Clinical Services (“NCS”).

The Company intends to continue development on a wide variety of projects intended to broaden surgical applications for greater procedural integration of its MAS techniques and additional applications of the MAGEC technology. Such

applications include tumor, trauma, and deformity, as well as increased fixation options and sagittal alignment products. The Company also expects to continue expanding its other product and services offerings as it executes on its strategy to offer customers an end-to-end, integrated procedural solution for spine surgery.

#### Basis of Presentation and Principles of Consolidation

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

7

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Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The accompanying Unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. These Unaudited Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2015 included in the Company’s Annual Report on Form 10-K filed with the SEC. In the opinion of management, the Unaudited Consolidated Financial Statements include all adjustments that are of a normal and recurring nature that are necessary for the fair presentation of the Company’s financial position and of the results of operations and cash flows for the periods presented.

The Company has reclassified historically presented product line revenue to conform to the current period presentation. The Company has also reclassified certain operating expenses into business transition costs. Both reclassifications have no impact on previously reported results of operations or financial position. Refer to section “Recently Adopted Accounting Standards” below for information regarding historical financial information adjusted for a change in accounting policy.

Change in Accounting Estimates

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

Recent Accounting Pronouncements Not Yet Adopted

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

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

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases, which outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new accounting standard requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new accounting standard must be adopted using the modified retrospective approach and will be effective for the Company starting in the first quarter of fiscal 2019. Early adoption is permitted. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments – Credit Losses, which changes the accounting for recognizing impairments of financial assets. Under the new guidance, credit losses for certain types of financial instruments will be estimated based on expected losses. The new guidance also modifies the impairment models for available-for-sale debt securities and for purchased financial assets with credit deterioration since their origination. The new guidance will be effective for the Company starting in the first quarter of fiscal 2021. Early adoption is permitted starting in the first quarter of fiscal 2020. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”), which eliminates the diversity in practice related to the classification of certain cash receipts and payments for debt prepayment or extinguishment costs, the maturing of a zero coupon bond, the settlement of contingent liabilities arising from a business combination, proceeds from insurance settlements, distributions from certain equity method investees and beneficial interests obtained in a financial asset securitization. ASU 2016-15 designates the appropriate cash flow classification, including requirements to allocate certain components of these cash receipts and payments among operating, investing and financing activities. The retrospective transition method, requiring adjustment to all comparative periods presented, is required unless it is impracticable for some of the amendments, in which case those amendments would be prospectively as of the earliest date practicable. This update is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted, including adoption in an interim period. The Company does not expect the adoption to have any significant impact on its consolidated financial statements.

Recently Adopted Accounting Standards

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

In March 2016, the FASB issued Accounting Standards Update 2016-09, Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), which simplifies the accounting for employee share-based payments. The new standard requires the immediate recognition of all excess tax benefits and deficiencies in the income statement, and requires classification of excess tax benefits as an operating activity as opposed to a financing activity in the statements of cash flows. The provisions of the new standard are effective for the Company beginning January 1, 2017, with early adoption permitted. The Company elected to early adopt ASU 2016-09 in the second quarter 2016, which requires any adjustments to be recorded as of the beginning of fiscal 2016. As a result, the Company recorded a modified retrospective adjustment of \$16.6 million to deferred tax assets and accumulated deficit as of January 1, 2016, and a retrospective adjustment to the previously reported first quarter 2016 provision for income taxes

of approximately \$5.5 million for the recognition of excess tax benefits in the provision for income taxes rather than additional paid-in capital. This resulted in a decrease in net loss per share of \$0.11 for the three months ended March 31, 2016. The Company elected to apply the change in classification for excess tax benefits in the statement of cash flows on a prospective basis, and elected to continue estimating stock-based compensation award forfeitures in determining the amount of compensation cost to be recognized each period.

#### Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) includes unrealized gains or losses on the Company's marketable securities and foreign currency translation adjustments. The cumulative translation adjustments included in accumulated other comprehensive income (loss) were a net cumulative loss of \$5.9 million and \$11.6 million at September 30, 2016 and December 31, 2015, respectively.

#### Business Transition Costs

The Company incurs certain costs related to acquisition, integration and business transition activities which include severance, relocation, consulting, leasehold exit costs, third party merger and acquisitions costs and other costs directly associated with such activities. The Company incurred \$3.5 million and \$11.5 million of business transition costs during the three and nine months ended September 30, 2016, respectively, primarily related to acquisition and integration activities.



Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

During the three and nine months ended September 30, 2015, the Company incurred \$0.9 million and \$10.8 million, respectively, of such costs, which included a \$3.4 million charge associated with the resignation of the Company's former Chief Executive Officer and Chairman of the Board, which occurred in the first quarter 2015. The \$3.4 million charge includes certain severance and compensation-related charges, net of certain forfeitures of previously recognized equity-based compensation.

Included in business transition costs were the restructuring and impairment charges associated with the Company's exit of its New Jersey location and termination of the respective lease. The Company incurred charges of \$0.5 million and \$2.3 million associated with this activity during the nine months ended September 30, 2016 and September 30, 2015, respectively. As of September 30, 2016, the total recorded liability associated with this early lease termination was \$2.9 million compared to \$4.1 million at December 31, 2015. The liability consists of future rental payments through 2017. The current portion of the liability is recorded within accounts payable and accrued liabilities and the long-term portion is recorded within other long-term liabilities in the Consolidated Balance Sheets for the periods presented.

Product Shipment Costs

Product shipment costs, included in sales, marketing and administrative expense in the accompanying Consolidated Statements of Operations, were \$5.7 million and \$18.4 million for the three and nine months ended September 30, 2016, respectively, and \$5.6 million and \$15.8 million for the three and nine months ended September 30, 2015 respectively. The majority of the Company's shipping costs are related to the loan of instrument sets, which are not sold as part of the Company's core sales offering. Amounts billed to customers for shipping and handling of products are reflected in revenues and are not significant for any period presented.

Litigation Liability Gain (Loss)

During the nine months ended September 30, 2016, the Company agreed to settle its ongoing litigation with Medtronic. As a result of the settlement, the Company paid \$45.0 million to Medtronic and accordingly recorded a gain of \$43.3 million related to the settlement. During the nine months ended September 30, 2015, the Company recorded a litigation liability gain of \$42.5 million resulting primarily from the recognition of a \$56.4 million gain stemming from a favorable appeal in Phase 1 of the Medtronic litigation and a gain of \$2.8 million in litigation accrual change related to the settlement of the NeuroVision trademark litigation, partially offset by litigation losses of \$13.8 million in connection with the OIG investigation and \$2.8 million in a general litigation matter.

See Note 11 and Note 12 to the Unaudited Consolidated Financial Statements for further discussion.

2. Net Income Per Share

The following table sets forth the computation of basic and diluted income per share attributable to the Company:

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(in thousands, except per share data)	Three Months		Nine Months	
	Ended September 30, 2016	2015	Ended September 30, 2016	2015
<b>Numerator:</b>				
Net income attributable to NuVasive, Inc.	\$3,926	\$12,960	\$30,771	\$54,788
<b>Denominator for basic and diluted net income per share:</b>				
Weighted average common shares outstanding for basic	50,264	48,993	49,970	48,513
<b>Dilutive potential common stock outstanding:</b>				
Stock options and employee stock purchase plan	223	895	347	1,224
Restricted stock units	1,483	1,129	1,221	1,127
Warrants	2,141	417	986	139
Senior Convertible Notes	1,671	1,765	974	1,199
Weighted average common shares outstanding for diluted	55,782	53,199	53,498	52,202
Basic net income per share attributable to NuVasive, Inc.	\$0.08	\$0.26	\$0.62	\$1.13
Diluted net income per share attributable to NuVasive, Inc.	\$0.07	\$0.24	\$0.58	\$1.05

10

Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following weighted-average outstanding common stock equivalents were not included in the calculation of net income per diluted share because their effects were anti-dilutive:

(in thousands)	Three Months Ended September		Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock options, employee stock purchase plan, and restricted stock units	6	13	1,213	53
Warrants	10,865	—	14,050	6,369
Senior Convertible Notes	—	—	10,067	—
Total	10,871	13	25,330	6,422

As discussed in Note 1 to the Unaudited Consolidated Financial Statements, the Company elected to early adopt ASU 2016-09 in the second quarter 2016, which requires any adjustments to be recorded as of the beginning of the fiscal year. The retrospective adjustments to the Company's financial results for the three months ended March 31, 2016 included a decrease in net loss attributable to the Company of \$5.5 million, which resulted in a decrease in net loss per share of \$0.11. The financial information in the table above for the nine months ended September 30, 2016 reflects this retrospective adjustment to the Company's financial results for the three months ended March 31, 2016.

### 3. Financial Instruments and Fair Value Measurements

The Company maintains an investment policy that requires a diversified investment portfolio in terms of types, maturities, and credit exposure, and invests with institutions that have high credit quality. Annually, the Company reassesses the investment policy to ensure it is reflective of current markets and conditions. The Company does not currently hold financial instruments for speculative purposes.

The composition of marketable securities is as follows:

(in thousands, except years)	Contractual Maturity (in years)	Amortized Cost	Gross	Gross	Fair Value
			Unrealized Gains	Unrealized Losses	

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September 30, 2016:					
Classified as current assets					
Corporate notes	Less than 1	\$—	—	\$ —	\$—
Commercial paper	Less than 1	—	—	—	—
Securities of government-sponsored entities	Less than 1	—	—	—	—
Short-term marketable securities		—	—	—	—
Classified as non-current assets					
Securities of government-sponsored entities	1 to 2	—	—	—	—
Corporate notes	1 to 2	—	—	—	—
Long-term marketable securities		—	—	—	—
Total marketable securities at September 30, 2016		\$—	\$ —	\$ —	\$—

December 31, 2015:					
Classified as current assets					
Certificates of deposit	Less than 1	\$ 6,615	\$ —	\$ —	\$6,615
Corporate notes	Less than 1	108,739	5	(173 )	108,571
Commercial paper	Less than 1	21,991	—	—	21,991
Securities of government-sponsored entities	Less than 1	28,284	—	(38 )	28,246
Short-term marketable securities		165,629	5	(211 )	165,423
Classified as non-current assets					
Certificates of deposit	1 to 2	12,392	—	—	12,392
Corporate notes	1 to 2	43,857	—	(109 )	43,748
Securities of government-sponsored entities	1 to 2	56,412	—	(220 )	56,192
Long-term marketable securities		112,661	—	(329 )	112,332
Total marketable securities at December 31, 2015		\$ 278,290	\$ 5	\$ (540 )	\$277,755

Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

As of September 30, 2016, the Company had liquidated its short-term and long-term marketable securities, and only held investments in securities classified as cash equivalents. During the periods presented, the Company did not hold any investments that were in a significant unrealized loss position and no impairment charges were recorded. Realized gains and losses and interest income related to marketable securities were immaterial during all periods presented.

## Foreign Currency and Derivative Financial Instruments

The Company translates the financial statements of its foreign subsidiaries using end-of-period exchange rates for assets and liabilities and average exchange rates during each reporting period for results of operations.

Some of the Company's reporting entities conduct a portion of their business in currencies other than the entity's functional currency. These transactions give rise to receivables and payables that are denominated in currencies other than the entity's functional currency. The value of these receivables and payables is subject to changes in currency exchange rates from the point at which the transactions are originated until the settlement in cash. Both realized and unrealized gains and losses in the value of these receivables and payables are included in the determination of net income. Net foreign currency exchange (losses) gains, which include gains and losses from derivative instruments, were \$(0.1) million and \$0.1 million for the three and nine months ended September 30, 2016, respectively, and \$0.4 million and \$0.4 million for the three and nine months ended September 30, 2015, respectively, and are included in other income (loss), net, in the Consolidated Statements of Operations.

The Company maintains a foreign currency risk management strategy that uses derivative instruments to protect against fluctuations in earnings and cash flows that may rise from volatility in currency exchange rates. The Company uses foreign currency forward exchange contracts to hedge the currency exchange rate exposure from short-term intercompany receivables and payables denominated in a currency other than the reporting entity's functional currency. Realized and unrealized gains or losses on forward contracts are included in the determination of net income as the forward contracts are not designated for hedge accounting under ASC Topic 815, Derivatives and Hedging. The foreign currency forward contracts effectively lock in the exchange rate at which the specific intercompany receivables and payables will be settled, so that gains or losses on the forward contracts offset the gains or losses from changes in the value of the underlying receivables and payables. The forward contracts are generally settled monthly. As of September 30, 2016 and September 30, 2015 notional principal amount of \$14.4 million and \$16.8 million, respectively, in foreign currency forward contracts was outstanding to hedge currency risk relative to the Company's foreign receivables and payables.

The following table summarizes the fair values of derivative instruments at September 30, 2016 and December 31, 2015:

Asset Derivatives	Liability Derivatives
Fair Value	Fair Value
Balance Sheet	Balance Sheet

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(in thousands)	Location	September		Location	September	
		30, 2016	31, 2015		30, 2016	31, 2015
Derivative instruments not designated as cash flow hedges						
Forward exchange contracts	Other current assets	\$ —	\$ 46	Other current liabilities	\$ 26	—
Total derivatives		\$ —	\$ 46		\$ 26	—

12

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Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes the effect of derivative instruments on the Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and September 30, 2015:

(in thousands)	Three Months Ended September 30, 2016		Three Months Ended September 30, 2015	
	Location of (Gain)/Loss	Amount of (Gain)/Loss	Location of (Gain)/Loss	Amount of (Gain)/Loss
	Recognized in Income	Recognized in Income	Recognized in Income	Recognized in Income
Derivative instruments not designated as cash flow hedges				
Forward exchange contracts	Other (income)		Other (income)	
		expense	expense	\$ 79
Total derivatives		\$ 176		\$ 79
	Nine Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	Location of (Gain)/Loss	Amount of (Gain)/Loss	Location of (Gain)/Loss	Amount of (Gain)/Loss
	Recognized in Income	Recognized in Income	Recognized in Income	Recognized in Income
Derivative instruments not designated as cash flow hedges				
Forward exchange contracts	Other (income)		Other (income)	
		expense	expense	\$ (1,585 )
Total derivatives		\$ 344		\$ (1,585 )

## Fair Value Measurements

The Company measures certain assets and liabilities in accordance with authoritative guidance which requires fair value measurements be classified and disclosed in one of the following three categories:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

Assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurements. The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels for certain assets or liabilities within the fair value hierarchy.



Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The fair values of the Company's assets and liabilities, including cash equivalents, marketable securities, restricted investments, derivatives, and contingent consideration liabilities are measured at fair value on a recurring basis, and are determined under the fair value categories in accordance with the authoritative guidance as follows:

(in thousands)	Total	Quoted Price in Active Market (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2016:</b>				
Money market funds	\$86,557	\$ 86,557	\$ —	\$ —
Corporate notes	5,505	—	5,505	—
Commercial paper	59,938	—	59,938	—
<b>Total assets</b>	<b>\$152,000</b>	<b>\$ 86,557</b>	<b>\$ 65,443</b>	<b>\$ —</b>
<b>December 31, 2015:</b>				
Money market funds	\$68,425	\$ 68,425	\$ —	\$ —
Certificates of deposit	19,007	19,007	—	—
Corporate notes	152,319	—	152,319	—
Commercial paper	21,991	—	21,991	—
Securities of government-sponsored entities	115,929	—	115,929	—
<b>Total assets</b>	<b>\$377,671</b>	<b>\$ 87,432</b>	<b>\$ 290,239</b>	<b>\$ —</b>

The Company did not have any transfers of assets and liabilities between the levels of the fair value measurement hierarchy during the three and nine months ended September 30, 2016 or September 30, 2015, respectively.

The carrying amounts of certain financial instruments such as cash equivalents, accounts receivable, prepaid expenses, other current assets, accounts payable, accrued expenses, and other current liabilities as of September 30, 2016 and December 31, 2015 approximate their related fair values due to the short-term maturities of these instruments. The carrying values of the Company's capital lease obligations approximate their related fair values as of September 30, 2016 and December 31, 2015.

The fair value, based on a quoted market price (Level 1), of the Company's outstanding Senior Convertible Notes due 2017 at September 30, 2016 and December 31, 2015 were approximately \$197.1 million and \$551.4 million, respectively. The fair value, based on a quoted market price (Level 1), of the Company's outstanding Senior Convertible Notes due 2021 was \$822.0 million at September 30, 2016. See Note 6 to the Unaudited Consolidated Financial Statements for further discussion on the carrying value of the Company's Senior Convertible Notes.

**Contingent Consideration Liabilities**

The following table sets forth the changes in the estimated fair value of the Company's liabilities measured on a recurring basis using significant unobservable inputs (Level 3):

(in thousands)	Nine Months Ended September 30,	
	2016	2015
Fair value measurement at beginning of period	\$—	\$644
Contingent consideration liability recorded upon acquisition	63,442	—
Change in fair value measurement	2,291	(36 )
Changes resulting from foreign currency fluctuations	209	—
Contingent consideration paid or settled	(582 )	(608)
Fair value measurement at end of period	\$65,360	\$—

The fair value of contingent consideration liabilities assumed in business combinations is recorded as part of the purchase price consideration of the acquisition, and is determined using a discounted cash flow model or probability simulation model. The significant inputs of such models are not observable in the market, such as certain financial metric growth rates, volatility rates, projections associated with the applicable milestone, the interest rate, the related probabilities and payment structure in the contingent consideration arrangement. Fair value adjustments to contingent consideration liabilities are recorded through operating expenses in the Consolidated Statement of Operations. Contingent consideration arrangements assumed by an asset purchase will be measured and accrued when such contingency is resolved.

Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

During the nine months ended September 30, 2016, the Company recorded additional contingent consideration liabilities of \$63.4 million in connection with certain acquisitions. Such acquisitions include the acquisition in September 2016 of an imaging software and technology platform known as Lessray®, which can be incorporated into the Company's MAS platform and forms a foundational element in the Company's imaging, navigation and automation platform development strategy, for which the Company recorded a preliminary purchase accounting fair value estimate for \$36.0 million of contingent consideration liabilities, and acquisitions completed in the first quarter of 2016 for which the Company recorded contingent consideration liabilities of \$21.4 million as part of the purchase consideration for such acquisitions. At September 30, 2016, the contingent consideration liabilities were \$65.4 million, and were recorded in the Consolidated Balance Sheet commensurate with the respective payable terms. See Note 5 to the Unaudited Consolidated Financial Statements for further discussion on contingent consideration liabilities assumed in business combinations.

## Non-financial assets and liabilities measured on a nonrecurring basis

Certain non-financial assets and liabilities are measured at fair value, usually with Level 3 inputs including discounted cash flow method or cost method, on a nonrecurring basis in accordance with authoritative guidance. In general, non-financial assets, including intangible assets and property and equipment, are measured at fair value when there is an indication of impairment and are recorded at fair value only when any impairment is recognized. Any impairment charges recognized in the Consolidated Statements of Operations were immaterial for the periods presented.

## 4. Goodwill and Intangible Assets

Goodwill and intangible assets consisted of the following:

(in thousands, except years)	Weighted-Average Amortization Period	Gross Amount	Accumulated Amortization	Intangible Assets, net
September 30, 2016:	(in years)			
<b>Intangible assets subject to amortization:</b>				
Developed technology	8	\$ 246,948	\$ (58,589 )	\$ 188,359
Manufacturing know-how and trade secrets	12	21,809	(14,460 )	7,349
Trade name and trademarks	9	25,700	(7,205 )	18,495
Customer relationships	9	125,722	(35,997 )	89,725
Total intangible assets subject to amortization	9	\$ 420,179	\$ (116,251 )	\$ 303,928

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Intangible assets not subject to amortization:

Goodwill	\$ 498,686
Total goodwill and intangible assets, net	\$ 802,614

	Weighted- Average Amortization Period	Gross Amount	Accumulated Amortization	Intangible Assets, net
December 31, 2015:	(in years)			
<b>Intangible assets subject to amortization:</b>				
Developed technology	9	\$92,648	\$ (37,382 )	\$ 55,266
Manufacturing know-how and trade secrets	12	21,787	(13,296 )	8,491
Trade name and trademarks	11	9,500	(5,068 )	4,432
Customer relationships	8	44,752	(27,865 )	16,887
Total intangible assets subject to amortization	10	\$ 168,687	\$ (83,611 )	\$ 85,076
<b>Intangible assets not subject to amortization:</b>				
Goodwill				\$ 154,281
Total goodwill and intangible assets, net				\$ 239,357

Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

During the nine months ended September 30, 2016, in connection with acquisitions and other investments, the Company recorded additions to definite-lived intangible assets and goodwill of \$251.5 million and \$343.6 million, respectively. Goodwill recorded in business combinations is primarily attributable to synergies expected to arise after the acquisition. See Note 5 to the Unaudited Consolidated Financial Statements for further discussion on assets acquired in business combinations and asset acquisitions.

The following table summarizes the changes in the carrying value of the Company's goodwill:

(in thousands)	
December 31, 2015	
Gross goodwill	\$162,581
Accumulated impairment loss	(8,300 )
	154,281
Changes to gross goodwill	
Increases recorded in business combinations	343,620
Changes resulting from foreign currency fluctuations	785
	344,405
September 30, 2016	
Gross goodwill	506,986
Accumulated impairment loss	(8,300 )
	\$498,686

Total expense related to the amortization of intangible assets, which is recorded in both cost of goods sold and operating expenses in the Consolidated Statements of Operations, was \$12.3 million and \$4.0 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and \$32.6 million and \$11.7 million for the nine months ended September 30, 2016 and September 30, 2015, respectively.

Total future amortization expense related to intangible assets subject to amortization at September 30, 2016 is set forth in the table below:

(in thousands)	
Remaining 2016	\$12,851
2017	48,217
2018	46,122
2019	44,438
2020	43,982
2021	42,063
Thereafter through 2027	66,255

Total future amortization expense \$303,928

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 5. Business Combinations

The Company recognizes the assets acquired, liabilities assumed, and any non-controlling interest at fair value at the date of acquisition. Certain acquisitions contained contingent consideration arrangements that required the Company to assess the acquisition date fair value of the contingent consideration liabilities, which was recorded as part of the purchase consideration of the acquisition with subsequent fair value adjustments to the contingent consideration recorded in the Consolidated Statements of Operations commensurate with the nature of the contingent consideration.

## Acquisition of Ellipse Technologies, Inc.

On February 11, 2016, the Company acquired all of the stock interest in Ellipse Technologies, Inc., which now operates as a wholly owned subsidiary of the Company under the renamed legal entity NuVasive Specialized Orthopedics, Inc. (“NSO”), for a purchase price of \$380.0 million (including holdbacks for retained employment of Ellipse Technologies leadership that is to be expensed and is not considered part of the final purchase price) and a potential milestone payment of \$30.0 million payable in cash in 2017 related to the achievement of a specific revenue target. If the revenue target is not achieved no payment will be due. A cash payment of \$382.2 million, which included additional amounts for cash on hand and traditional working capital adjustments, was transferred at the closing. Subsequent to the closing payment, the Company received \$0.6 million from the escrow for traditional working capital adjustments finalized after the closing.

NSO designs and sells expandable growing rod implant systems that can be non-invasively lengthened following implantation with precise, incremental adjustments via an external remote controller using magnetic technology called MAGnetic External Control, or MAGEC. The technology platform provides the basis of NSO’s core product offerings, including MAGEC-EOS, which allows for the minimally invasive treatment of early-onset and adolescent scoliosis, as well as the PRECICE limb lengthening system, which allows for the correction of long bone limb length discrepancy, as well as enhanced bone healing in patients that have experienced traumatic injury.

The Company applied certain assumptions and findings in the valuation outcome for the assets acquired and liabilities assumed, for which the allocation of the purchase price is based on their fair values, as follows:

(in thousands)	
Cash paid for purchase	\$381,579
Accounts receivable	7,148
Inventory	22,451
Other current assets	1,855
Property, plant and equipment, net	6,725
Definite-lived intangible assets:	
Developed technology	133,900
Customer relationships	33,200
Trade names	16,200

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Goodwill	242,805
Deferred tax assets	17,694
Other assets	1,868
Contingent consideration liability	18,800
Deferred tax liabilities	75,999
Other liabilities assumed	7,468
	\$381,579

Goodwill recognized in this transaction is not deductible for income tax purposes. Goodwill largely consists of expected revenue synergies resulting from the combination of product portfolios, cost synergies related to elimination of redundant facilities, functions and staffing; use of the Company's existing commercial infrastructure to expand sales of NSO's products; and the assembled workforce. The intangible assets acquired will be amortized on a straight-line basis over weighted-average useful lives of seven years, nine years and seven years for technology-based, customer-related intangible assets, and trade name related intangible assets, respectively. The estimated fair values of the intangible assets acquired were primarily determined using the income approach based on significant inputs that were not observable.



Table of Contents

NUVASIVE, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In connection with the acquisition, a contingent liability of \$18.8 million was recorded as of March 31, 2016 for the potential revenue-based milestone payment. The liability was fair valued using the Monte Carlo simulation based on specific revenue achievement scenarios and discount factors. Changes in fair value of the liability over the measurement period are recorded in the results of operations in the Consolidated Statements of Operations. The fair value of the liability at September 30, 2016 was \$21.6 million and recorded in current liabilities in the Consolidated Balance Sheet.

Acquisition costs of \$4.0 million were recognized as selling, marketing and administrative expenses as incurred. The Company's results of operations included the operating results of NSO, since the date of acquisition, of \$15.0 million and \$35.8 million of revenue for the three and nine months ended September 30, 2016, respectively, and net income of \$0.9 million and \$0.1 million for the three and nine months ended September 30, 2016, respectively, in the Unaudited Consolidated Statement of Operations.

The following table presents the unaudited pro forma results for the three and nine months ended September 30, 2016 and September 30, 2015. The unaudited pro forma financial information combines the results of operations of NuVasive and Ellipse Technologies as though the companies had been combined as of January 1, 2015, and the pro forma information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at such times. The unaudited pro forma results presented include non-recurring adjustments directly attributable to the business combination, some of which are presented in the comparable period results instead of the current period by nature of such adjustments. The adjustments for amortization charges for acquired intangible assets were \$6.5 million and \$19.5 million for the three and nine months ended September 30, 2015, respectively. The adjustments to cost of sales for increased fair value of acquired inventory of \$(14.7) million and \$14.7 million for the nine months ended September 30, 2016 and September 30, 2015, respectively, were only applicable to the nine months ended periods presented. The nine month period 2015 also includes an adjustment of \$4.0 million for acquisition related expenses. All periods presented include immaterial adjustments to revenue for deferred revenue adjustments, and related tax effects to the pre-tax income. The pre-acquisition accounting policies of Ellipse Technologies were materially similar to the Company, with the differences adjusted to reflect the accounting policies of the Company in the unaudited pro forma results presented.

(in thousands, except per share amounts)	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Revenues	\$239,708	\$212,821	\$697,010	\$628,241
Net income attributable to NuVasive, Inc.	6,982	7,176	31,444	27,901
Net income per share attributable to NuVasive, Inc.:				
Basic	\$0.14	\$0.15	\$0.63	\$0.58
Diluted	\$0.13	\$0.13	\$0.59	\$0.53

Other Acquisitions

On July 1, 2016, the Company acquired all of the stock interest in BNN Holdings Corp., for a purchase price of \$98.0 million. BNN Holdings Corp., through its subsidiaries and affiliates, owns and operates Biotronic NeuroNetwork, a patient-centric healthcare organization that provides intraoperative neurophysiological monitoring services to surgeons and healthcare facilities across the U.S. A cash payment of \$94.0 million was transferred at the closing, which represented the total purchase consideration, net of amounts retained for certain acquired provisional obligations, additional amounts for cash on hand and traditional working capital adjustments. The acquisition was not considered material to the overall Unaudited Consolidated Financial Statements.

The Company combined the service offerings of Biotronic NeuroNetwork with its Impulse Monitoring, Inc. business under the newly created division NuVasive Clinical Services (“NCS”).

The Company has completed other acquisitions that were not considered material to the overall Unaudited Consolidated Financial Statements during the periods presented. These acquisitions have been included in the Unaudited Consolidated Financial Statements from the respective dates of acquisition. The Company does not believe that collectively the acquisitions made during the year, excluding NSO, are material to the overall financial statements.

For certain acquisitions completed during the nine months ended September 2016, the Company is still in the process of finalizing the purchase price allocation given the timing of the acquisition and the size and scope of the assets and liabilities subject to valuation. While the Company does not expect material changes in the valuation outcome, certain assumptions and findings that were in place at the date of acquisition could result in changes in the purchase price allocation. The Company anticipates finalizing the purchase price allocation in the fourth quarter of 2016.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## Variable Interest Entities

## Progentix Orthobiology B.V.

In 2009, the Company completed the purchase of 40% of the capital stock of Progentix Orthobiology B.V. (“Progentix”), a company organized under the laws of the Netherlands, from existing shareholders (the “Progentix Shareholders”) pursuant to a Preferred Stock Purchase Agreement for \$10.0 million in cash (the “Initial Investment”). As of September 30, 2016, the Company has loaned Progentix cumulatively \$5.3 million at an interest rate of 6% per year. The Company is not obligated to provide additional funding. Concurrently, with the Initial Investment, the Company and Progentix entered into a Distribution Agreement (as amended, the “Distribution Agreement”), whereby Progentix appointed the Company as its exclusive distributor for certain Progentix products. The Distribution Agreement is in effect for a term of ten years unless terminated earlier in accordance with its terms.

In accordance with authoritative guidance, the Company has determined that Progentix is a variable interest entity (“VIE”), as it does not have the ability to finance its activities without additional subordinated financial support and its equity investors will not absorb their proportionate share of expected losses and will be limited in the receipt of the potential residual returns of Progentix.

Total assets and liabilities of Progentix included in the accompanying Consolidated Balance Sheets are as follows:

(in thousands)	September 30, 2016	December 31, 2015
Total current assets	\$ 346	\$ 353
Identifiable intangible assets, net	11,437	13,048
Goodwill	12,654	12,654
Accounts payable and accrued expenses	481	574
Deferred tax liabilities, net	1,050	1,496
Non-controlling interests	5,998	7,309

The following is a reconciliation of equity (net assets) attributable to the non-controlling interests:

(in thousands)	Nine Months Ended September 30,	
	2016	2015
Non-controlling interests at beginning of period	\$7,309	\$8,310
Less: Net loss attributable to the non-controlling interests	1,311	601
Non-controlling interests at end of period	\$5,998	\$7,709

Impulse Monitoring, Inc. and Physician Practices

The Company maintains contractual relationships with several physician practices (“PCs”) which were inherited through the 2011 acquisition of Impulse Monitoring, Inc. and the 2016 acquisition of BNN Holdings Corp. In accordance with authoritative guidance, the Company has determined that the PCs are VIEs and therefore, the accompanying Consolidated Financial Statements include the accounts of the PCs from the date of acquisition. During the periods presented, the result of PCs was immaterial to the Company’s financials. The creditors of the PCs have claims only on the assets of the PCs, which are not material, and the assets of the PCs are not available to the Company.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 6. Indebtedness

The carrying values of the Company's Senior Convertible Notes are as follows:

(in thousands)	September 30, 2016	December 31, 2015
<b>2.75% Senior Convertible Notes due 2017:</b>		
Principal amount	\$ 125,732	\$ 402,500
Unamortized debt discount	(4,172 )	(25,958 )
Unamortized debt issuance costs	(585 )	(3,622 )
	120,975	372,920
<b>2.25% Senior Convertible Notes due 2021:</b>		
Principal amount	650,000	—
Unamortized debt discount	(76,554 )	—
Unamortized debt issuance costs	(13,496 )	—
	559,950	—
<b>Total Senior Convertible Notes</b>	<b>\$ 680,925</b>	<b>\$ 372,920</b>
<b>Less Current Portion:</b>	<b>(120,975 )</b>	<b>—</b>
Long-term Senior Convertible Notes	\$ 559,950	\$ 372,920

## 2.25% Senior Convertible Notes due 2021

In March 2016, the Company issued \$650.0 million principal amount of unsecured Senior Convertible Notes with a stated interest rate of 2.25% and a maturity date of March 15, 2021 (the "2021 Notes"). The net proceeds from the offering, after deducting initial purchasers' discounts and costs directly related to the offering, were approximately \$634.1 million. The 2021 Notes may be settled in cash, stock, or a combination thereof, solely at the Company's discretion. It is the Company's current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of the Company's common stock. The initial conversion rate of the 2021 Notes is 16.7158 shares per \$1,000 principal amount, which is equivalent to a conversion price of approximately \$59.82 per share, subject to adjustments. The Company uses the treasury share method for assumed conversion of the 2021 Notes to compute the weighted average shares of common stock outstanding for diluted earnings per share. The Company also entered into transactions for convertible note hedge (the "2021 Hedge") and warrants (the "2021 Warrants") concurrently with the issuance of the 2021 Notes.

The cash conversion feature of the 2021 Notes required bifurcation from the Notes and was initially accounted for as an equity instrument classified to stockholders' equity, which resulted in recognizing \$84.8 million in additional paid-in-capital during 2016.

The interest expense recognized on the 2021 Notes during the three months ended September 30, 2016 includes \$3.7 million, \$3.8 million and \$0.6 million for the contractual coupon interest, the accretion of the debt discount and the amortization of the debt issuance costs, respectively. The interest expense recognized on the 2021 Notes during the nine months ended September 30, 2016 includes \$7.9 million, \$8.2 million and \$1.3 million for the contractual coupon interest, the accretion of the debt discount and the amortization of the debt issuance costs, respectively. The effective interest rate on the 2021 Notes is 5.8%, which includes the interest on the notes, amortization of the debt discount and debt issuance costs. Interest on the 2021 Notes began accruing upon issuance and is payable semi-annually.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Prior to September 15, 2020, holders may convert their 2021 Notes only under the following conditions: (a) during any calendar quarter beginning June 30, 2016, if the reported sale price of the Company's common stock for at least 20 days out of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than 130% of the conversion price on each applicable trading day; (b) during the five business day period in which the trading price of the 2021 Notes falls below 98% of the product of (i) the last reported sale price of the Company's common stock and (ii) the conversion rate on that date; and (c) upon the occurrence of specified corporate events, as defined in the 2021 Notes. From September 15, 2020 and until the close of business on the second scheduled trading day immediately preceding March 15, 2021, holders may convert their 2021 Notes at any time (regardless of the foregoing circumstances). The Company may not redeem the 2021 Notes prior to March 20, 2019. The Company may redeem the 2021 Notes, at its option, in whole or in part on or after March 20, 2019 until the close of business on the business day immediately preceding September 15, 2020 if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which the Company delivers written notice of a redemption. The redemption price will be equal to 100% of the principal amount of such 2021 Notes to be redeemed plus accrued and unpaid interest to, but excluding, the redemption date. No principal payments are due on the 2021 Notes prior to maturity. Other than restrictions relating to certain fundamental changes and consolidations, mergers or asset sales and customary anti-dilution adjustments, the 2021 Notes do not contain any financial covenants and do not restrict the Company from paying dividends or issuing or repurchasing any of its other securities. The Company is unaware of any current events or market conditions that would allow holders to convert the 2021 Notes.

#### 2021 Hedge

In connection with the offering of the 2021 Notes, the Company entered into the hedge transaction with the initial purchasers and/or their affiliates (the "2021 Counterparties") entitling the Company to purchase up to 10,865,270 shares of the Company's common stock at an initial stock price of \$59.82 per share, each of which is subject to adjustment. The cost of the 2021 Hedge was \$111.2 million and accounted for as an equity instrument by recognizing \$111.2 million in additional paid-in-capital during 2016. The 2021 Hedge will expire on March 15, 2021. The 2021 Hedge is expected to reduce the potential equity dilution upon conversion of the 2021 Notes if the daily volume-weighted average price per share of the Company's common stock exceeds the strike price of the 2021 Hedge. An assumed exercise of the 2021 Hedge by the Company is considered anti-dilutive since the effect of the inclusion would always be anti-dilutive with respect to the calculation of diluted earnings per share.

#### 2021 Warrants

The Company sold warrants to the 2021 Counterparties to acquire up to 10,865,270 shares of the Company's common stock. The 2021 Warrants will expire on various dates from June 2021 through December 2021 and may be settled in cash or net shares. It is the Company's current intent and policy to settle all conversions in shares of the Company's common stock. The Company received \$44.9 million in cash proceeds from the sale of the 2021 Warrants, which was recorded in additional paid-in-capital. The 2021 Warrants could have a dilutive effect on the Company's earnings per share to the extent that the price of the Company's common stock during a given measurement period exceeds the

strike price of the 2021 Warrants, which is \$80.00 per share. The Company uses the treasury share method for assumed conversion of its 2021 Warrants to compute the weighted average common shares outstanding for diluted earnings per share.

*2.75% Senior Convertible Notes due 2017*

In June 2011, the Company issued \$402.5 million principal amount of Senior Convertible Notes with a stated interest rate of 2.75% and a maturity date of July 1, 2017 (the “2017 Notes”). The net proceeds from the offering, after deducting initial purchasers’ discounts and costs directly related to the offering, were approximately \$359.2 million. The 2017 Notes may be settled in cash, stock, or a combination thereof, solely at the Company’s discretion. It is the Company’s current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of the Company’s common stock. The initial conversion rate of the 2017 Notes is 23.7344 shares per \$1,000 principal amount, which is equivalent to a conversion price of approximately \$42.13 per share, subject to adjustments. The Company uses the treasury share method for assumed conversion of the 2017 Notes to compute the weighted average shares of common stock outstanding for diluted earnings per share. The Company also entered into transactions for convertible note hedge (the “2017 Hedge”) and warrants (the “2017 Warrants”) concurrently with the issuance of the 2017 Notes. In March 2016, the Company used approximately \$345.2 million of the net proceeds from the 2021 Notes offering to repurchase approximately \$276.8 million in principal amount outstanding of the \$402.5 million 2017 Notes. The repurchase of a portion of the 2017 Notes resulted in a remaining balance of \$125.7 million principal amount outstanding. For more details, refer to “Repurchase of Senior Convertible Notes due 2017”.



Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The cash conversion feature of the 2017 Notes required bifurcation from the Notes and was initially accounted for as a derivative liability and debt discount of \$88.9 million upon issuance of the Notes without authorization of issuing additional common stocks for the conversion. Upon obtaining stockholder approval for the additional authorized shares of the Company's common stock, the derivative liability was reclassified to stockholders' equity, which resulted in recognizing cumulatively \$39.5 million in other income for change in fair value measurement and \$49.4 million in additional paid-in-capital during 2011.

The interest expense recognized on the 2017 Notes during the three months September 30, 2016 includes \$0.9 million, \$1.3 million and \$0.2 million for the contractual coupon interest, the accretion of the debt discount and the amortization of debt issuance costs, respectively. The interest expense recognized on the 2017 Notes during the nine months ended September 30, 2016 includes \$4.2 million, \$6.3 million and \$0.9 million for the contractual coupon interest, the accretion of the debt discount and the amortization of the debt issuance costs, respectively. During the three months ended September 30, 2015, interest expense recognized on the 2017 Notes includes \$2.8 million, \$4.0 million and \$0.5 million for the contractual coupon interest, the accretion of the debt discount, and the amortization of the debt issuance costs, respectively. The interest expense recognized on the 2017 Notes during the nine months ended September 30, 2015 includes \$8.3 million, \$11.7 million and \$1.5 million for the contractual coupon interest, the accretion of the debt discount and the amortization of debt issuance costs, respectively. The effective interest rate on the 2017 Notes is 8.0%, which includes the interest on the notes, amortization of the debt discount and debt issuance costs. Interest on the 2017 Notes began accruing upon issuance and is payable semi-annually.

Prior to January 1, 2017, holders may convert their 2017 Notes only under the following conditions: (a) during any calendar quarter beginning October 1, 2011, if the reported sale price of the Company's common stock for at least 20 days out of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than 130% of the conversion price on each applicable trading day; (b) during the five business day period in which the trading price of the 2017 Notes falls below 98% of the product of (i) the last reported sale price of the Company's common stock and (ii) the conversion rate on that date; and (c) upon the occurrence of specified corporate events, as defined in the 2017 Notes. From January 1, 2017 and until the close of business on the second scheduled trading day immediately preceding July 1, 2017, holders may convert their 2017 Notes at any time (regardless of the foregoing circumstances). The Company may not redeem the 2017 Notes prior to maturity. Other than restrictions relating to certain fundamental changes and consolidations, mergers or asset sales and customary anti-dilution adjustments, the 2017 Notes do not contain any financial covenants and do not restrict the Company from paying dividends or issuing or repurchasing any of its other securities. At September 30, 2016, holders of the 2017 Notes were in a convertible position, as the reported sale price of the Company's common stock for 20 days out of the last 30 consecutive trading days ending with September 30, 2016 exceeded 130% of the \$42.13 per share conversion price on each applicable trading day. At September 30, 2016, a minimal amount of holders of the 2017 Notes had elected to convert their notes. The Company will settle such conversions in the fourth quarter 2016 through the combination settlement described above. The 2017 Notes are recorded as current liabilities on the September 30, 2016 consolidated balance sheet.

2017 Hedge

In connection with the offering of the 2017 Notes, the Company entered into the 2017 Hedge with the initial purchasers and/or their affiliates (the “2017 Counterparties”) entitling the Company to purchase up to 9,553,096 shares of the Company’s common stock at an initial stock price of \$42.13 per share, each of which is subject to adjustment. The cost of the 2017 Hedge was \$80.1 million and accounted for as derivative assets upon issuance of the 2017 Notes. Upon obtaining stockholder approval for the additional authorized shares of the Company’s common stock, the derivative asset was reclassified to stockholders’ equity, which resulted in recognizing cumulatively \$37.1 million in other expense for the change in fair value measurement and \$43.0 million in additional paid-in-capital during 2011. The 2017 Hedge will expire on July 1, 2017. The 2017 Hedge is expected to reduce the potential equity dilution upon conversion of the 2017 Notes if the daily volume-weighted average price per share of the Company’s common stock exceeds the strike price of the 2017 Hedge. An assumed exercise of the 2017 Hedge by the Company is considered anti-dilutive since the effect of inclusion would always be anti-dilutive with respect to the calculation of diluted earnings per share.

#### 2017 Warrants

The Company sold warrants to the 2017 Counterparties to acquire up to 477,654 shares of the Company’s Series A Participating Preferred Stock at an initial strike price of \$988.51 per share, subject to adjustment. Each share of Series A Participating Preferred Stock is convertible into 20 shares of the Company’s common stock, or up to 9,553,080 common shares in total. The 2017 Warrants will expire on various dates from September 2017 through January 2018 and may be settled in cash or net shares. It is the Company’s current intent and policy to settle all conversions in shares of the Company’s common stock. The Company received \$47.9 million in cash proceeds from the sale of the 2017 Warrants, which was recorded in additional paid-in-capital. The 2017 Warrants could have a dilutive effect on the Company’s earnings per share to the extent that the price of the Company’s common stock during a given measurement period exceeds the strike price of the 2017 Warrants. The Company uses the treasury share method for assumed conversion of its 2017 Warrants to compute the weighted average common shares outstanding for diluted earnings per share.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Repurchases of Senior Convertible Notes due 2017

In March 2016, the Company used approximately \$345.2 million of the net proceeds from the 2021 Notes offering to repurchase approximately \$276.8 million principal amount outstanding of the \$402.5 million principal Senior Convertible Notes due 2017, the associated conversion feature of the repurchased notes (which is recorded in additional paid-in capital), and the accrued interest on the repurchased notes. As a result of this repurchase, the Company recorded a loss in other expense on the accompanying Consolidated Statements of Operations for the nine months ended September 30, 2016 of approximately \$17.4 million for the early extinguishment of 2017 Notes and the related debt issuance costs that were previously capitalized in connection with the issuance of the 2017 Notes. The repurchase of a portion of the 2017 Notes resulted in remaining balances of \$125.7 million, \$6.8 million, and \$1.0 million of principal outstanding, debt discount, and debt issuance costs, respectively, at the time of the repurchase. The Company intends to use the remainder of the net proceeds from the 2021 Notes offering for general corporate purposes.

Revolving Senior Credit Facility

In February 2016, the Company entered into a Credit Agreement (the “Credit Agreement”) for a revolving senior credit facility (the “Facility”) that provides for secured revolving loans, multicurrency loan options and letters of credit in an aggregate amount of up to \$150.0 million. The Credit Agreement also contains an expansion feature, which allows the Company to increase the aggregate principal amount of the Facility provided the Company remains in compliance with the underlying financial covenants. The Facility matures February 8, 2021, and includes a sub-limit of \$15.0 million for letters of credit and a sub-limit of \$5.0 million for swing line loans. All assets of the Company and its material domestic subsidiaries are pledged as collateral under the Facility (subject to customary exceptions) pursuant to the term set forth in the Security and Pledge Agreement (the “Security Agreement”) executed in favor of the administrative agent by the Company. Each of the Company’s material domestic subsidiaries guarantees the Facility. At September 30, 2016 the Company does not carry any outstanding revolving loans under the Facility.

Borrowings under the Facility are used by us to provide financing for working capital and other general corporate purposes, including potential mergers and acquisitions. Loans under the Facility bear interest, at the option of the Company, at either LIBOR (determined in accordance with the Credit Agreement) plus an applicable margin ranging from 1.00 % - 2.00 % per annum subject to Company’s applicable consolidated leverage ratio or the Base Rate (determined in accordance with the Credit Agreement), plus an applicable margin ranging from 0.0% - 1.25% per annum subject to Company’s applicable consolidated leverage ratio. The Facility has a commitment fee, which accrues at a rate of 0.2% - 0.4% per annum (determined in accordance with the Credit Agreement) based on the Company’s current leverage ratio.

The Credit Agreement contains affirmative, negative and financial covenants, and events of default customary for financings of this type. The financial covenants require the Company to maintain ratios of consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) in relation to consolidated interest expense and consolidated debt, respectively, as defined in the Credit Agreement, at varying scales throughout the life of the Credit Agreement. The Facility grants the lenders preferred first priority liens and security interests in capital stock,

intercompany debt and all of the present and future property and assets of the Company and each guarantor.

23

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Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 7. Stock-Based Compensation

The compensation cost that has been included in the Consolidated Statements of Operations for all stock-based compensation arrangements was as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Sales, marketing and administrative expense	\$6,826	\$6,725	\$18,672	\$19,448
Research and development expense	399	288	805	920
Cost of goods sold	63	64	168	202
Stock-based compensation expense before taxes	7,288	7,077	19,645	20,570
Related income tax benefits	(2,915)	(2,831)	(7,858)	(8,228)
Stock-based compensation expense, net of taxes	\$4,373	\$4,246	\$11,787	\$12,342

At September 30, 2016, there was \$55.1 million of unamortized compensation expense for restricted stock units (“RSUs”) and performance-based restricted stock units (“PRSUs”) to be recognized over a weighted average period of 2.4 years.

## Stock Options and Purchase Rights

The weighted average assumptions used to estimate the fair value of stock purchase rights under the employee stock purchase plan (“ESPP”) are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
<b>ESPP</b>				
Volatility	30 %	40 %	31 %	43 %
Expected term (years)	0.5	1.3	0.5	1.3
Risk free interest rate	0.4 %	0.2 %	0.3 %	0.2 %
Expected dividend yield	— %	— %	— %	— %

Under the terms of the ESPP, shareowners can elect to have up to 15% of their annual compensation, up to a maximum of \$21,250 per year, withheld to purchase shares of the Company’s common stock for a purchase price equal to 85% of the lower of the fair market value per share (at closing) of the Company’s common stock on (i) the commencement date of the two-year or six-month offering period (depending on the purchase period enrolled), or (ii)

the respective purchase date.

The Company has not granted any options since 2011. The Company issued approximately 0.1 million and 1.5 million shares of common stock, before net share settlement, upon the exercise of outstanding stock options during the three and nine months ended September 30, 2016, respectively, and issued approximately 3.3 million shares of common stock upon the exercise of outstanding stock options during the year ended December 31, 2015.

#### Restricted Stock Units

The Company issued approximately 0.1 million and 0.8 million shares of common stock, before net share settlement, upon vesting of RSUs (including PRSUs) during the three and nine months ended September 30, 2016, respectively, and issued approximately 1.4 million shares of common stock in settlement of RSUs (including PRSUs) upon their vesting during the year ended December 31, 2015.

#### Assumed Equity Incentive Plan

In connection with the acquisition of Ellipse Technologies in February 2016 (see Note 5 to the Unaudited Consolidated Financial Statements), the Company assumed the Ellipse Technologies, Inc. 2015 Incentive Award Plan and the shares thereunder, subject to an equity exchange adjustment, for future awards by the Company.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 8. Income Taxes

Income taxes are determined using an estimated annual effective tax rate applied against income, and then adjusted for the tax impacts of certain significant and discrete items. For the nine months ended September 30, 2016, the Company treated the tax impact of the following as discrete events for which the tax effect was recognized separately from the application of the annual effective tax rate: tax benefits related to excess share-based payment in income tax expense resulting from the adoption of ASU 2016-09 as of January 1, 2016, changes to the beginning of the year valuation allowances and certain unrecognized tax benefits. See Note 1 to the Unaudited Consolidated Financial Statements for further discussion on the adoption of ASU 2016-09. The Company's effective tax rate recorded for the nine months ended September 30, 2016 was 37%.

In accordance with the disclosure requirements as described in ASC Topic 740, Income Taxes, the Company has classified unrecognized tax benefits as non-current income tax liabilities, or a reduction in deferred tax assets, unless expected to be paid within one year. The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had an increase in gross unrecognized tax benefits of approximately \$7.3 million during the nine months ended September 30, 2016, primarily related to research and development credits and costs incurred in the acquisition and integration of acquired entities. The Company does not anticipate there will be a significant change in unrecognized tax benefits within the next 12 months.

The Company is subject to routine compliance reviews on various tax matters around the world in the ordinary course of business. Currently, income tax audits are being conducted in the state of New York and the state of Louisiana. U.S. and most foreign jurisdictions remain subject to examination in all years due to prior year net operating losses and R&D credits.

## 9. Business Segment, Product and Geographic Information

The Company operates in one segment based upon the Company's organizational structure, the way in which the operations are managed and evaluated by the chief operating decision maker and the lack of availability of discrete financial information.

The Company operates under two distinct product lines; spinal hardware and surgical support. The Company's spinal hardware product line offerings include implants and fixation products, and following the acquisition of Ellipse Technologies, also include the MAGEC- EOS spinal bracing and lengthening system and the PRECICE limb lengthening system. The Company's surgical support product offerings include IOM services, disposables and biologics, all of which are used to aid spinal surgery. Revenue by product line was as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(in thousands)	2016	2015	2016	2015

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Spinal Hardware	\$ 162,831	\$ 138,948	\$ 486,030	\$ 410,225
Surgical Support	76,818	61,590	204,933	185,606
Total Revenue	\$ 239,649	\$ 200,538	\$ 690,963	\$ 595,831

Revenue and property and equipment, net, by geographic area were as follows:

(in thousands)	Revenue				Property and Equipment, Net	
	Three Months Ended		Nine Months Ended		September	December
	September 30,	September 30,	September 30,	September 30,	30,	31,
	2016	2015	2016	2015	2016	2015
United States	\$208,281	\$176,371	\$597,230	\$524,320	\$145,359	\$113,037
International (excludes Puerto Rico)	31,368	24,167	93,733	71,511	34,554	28,404
Total	\$239,649	\$200,538	\$690,963	\$595,831	\$179,913	\$141,441



Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

10. Commitments

Licensing and Purchasing Agreements

As of September 30, 2016, the Company has obligations under certain consultancy arrangements to pay up to approximately \$18.6 million in the aggregate in the event that specified revenue-based milestones are achieved prior to 2024. Any such payment will be made in a combination of cash and the Company's common shares as provided in the agreements. Any payments in satisfaction of these contingent obligations are considered a cost of goods sold and are recognized as and if milestones are achieved. These agreements expire on various dates through 2024.

Executive Severance Plans

The Company has employment contracts with key executives and maintains severance plans that provide for the payment of severance and other benefits if terminated for reasons other than cause, as defined in those agreements and plans. Certain agreements call for payments that are based on historical compensation, accordingly, the amount of the contractual commitment will change over time commensurate with the executive's applicable earnings. At September 30, 2016, future commitments for such key executives were approximately \$26.2 million. In certain circumstances, the agreements call for the acceleration of equity vesting. Those figures are not reflected in the above information.

Leasing Commitments Assumed in Business Combinations

In connection with the acquisition of Ellipse Technologies in February 2016, (see Note 5 to the Unaudited Consolidated Financial Statements for further information regarding the acquisition) the Company assumed the operating leases to its office facilities. The leases were determined to be of similar terms that would be expected to be provided to the Company had it entered into the leasing agreements independently. In connection with the operating leases, the Company acquired the security deposits recorded and maintained as restricted cash which total \$1.5 million as of September 30, 2016. As of September 30, 2016, the Company's future lease payment commitments associated with the assumed operating leases total \$6.6 million through the terms of the leases.

The terms of the leases assumed extend through 2020, and generally provide for periodic rent increases. Rent expense is recognized on a straight-line basis over the term of the lease. Accordingly, rent expense recognized in excess of rent paid is reflected as a liability in the accompanying Unaudited Consolidated Balance Sheets.

Additionally, the Company assumed leasing commitments in its other business combinations for which the business combinations and assumed leasing commitments individually and collectively were not considered material to the overall Unaudited Consolidated Financial Statements.

11. Contingencies

The Company is subject to potential liabilities under government regulations and various claims and legal actions that are pending or may be asserted from time-to-time. These matters arise in the ordinary course and conduct of the

Company's business and include, for example, commercial, intellectual property, environmental, securities and employment matters. The Company intends to continue to defend itself vigorously in such matters. Furthermore, the Company regularly assesses contingencies to determine the degree of probability and range of possible loss for potential accrual in its financial statements. During the nine months ended September 30, 2016, the Company agreed to settle its ongoing litigation with Medtronic. As a result of the settlement, the Company paid \$45.0 million to Medtronic and accordingly recorded a gain of \$43.3 million related to the settlement by reducing its previous accrual of \$88.3 million related to the matter.

In the first quarter of 2015 and during the nine months ended September 30, 2015, the Company had a gain of \$56.4 million related to a litigation accrual change resulting from the legal proceedings in Phase 1 of the Medtronic litigation whereby the damages award by the jury was overturned, and a gain of \$2.8 million in litigation accrual change related to settlement of the NeuroVision trademark litigation. This amount was offset by a litigation charge of \$13.8 million related to the Office of the Inspector General of the U.S. Department of Health and Human Services ("OIG") investigation and a \$3.3 million litigation charge in a general litigation matter. Refer to both the subsequent sections herein titled "Legal Proceedings" and to Note 12 to the Unaudited Consolidated Financial Statements for further information.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

An estimated loss contingency is accrued in the Company's financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Based on the Company's assessment, it has adequately accrued an amount for contingent liabilities currently in existence. The Company does not accrue amounts for liabilities that it does not believe are probable or that it considers immaterial to its overall financial position. Litigation is inherently unpredictable, and unfavorable resolutions could occur. As a result, assessing contingencies is highly subjective and requires judgment about future events. The amount of ultimate loss may exceed the Company's current accruals, and it is possible that its cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Legal Proceedings

Medtronic Sofamor Danek USA, Inc. Litigation

In August 2008, Warsaw Orthopedic, Inc., Medtronic Sofamor Danek USA, Inc. and other Medtronic related entities (collectively, "Medtronic") filed a patent infringement lawsuit against the Company in the United States District Court for the Southern District of California (the "Medtronic Litigation"), alleging that certain of the Company's products or methods, including the XLIF® procedure, infringe, or contribute to the infringement of, twelve U.S. patents assigned or licensed to Medtronic. Three of the patents were later withdrawn by Medtronic, leaving nine purportedly infringed patents. The Company brought counterclaims against Medtronic alleging infringement of certain of the Company's patents.

The case was administratively broken into several phases.

The first phase ("Phase 1") of the case included three Medtronic patents and one Company patent. The initial trial on the first phase of the case concluded on September 20, 2011 in the U.S. District Court for the Southern District of California, and a jury delivered an unfavorable verdict against the Company with respect to the three Medtronic patents and a favorable verdict with respect to the one Company patent at issue, including a monetary damages award of approximately \$101.2 million to Medtronic (the "2011 verdict"). Medtronic's subsequent motion for a permanent injunction was denied by the District Court. On May 15, 2013, the District Court granted the parties' joint motion to dismiss claims relating to one of the three Medtronic patents pursuant to a settlement agreement, leaving two Medtronic patents remaining in the litigation. On June 11, 2013, the District Court granted the parties ongoing royalties with respect to the two Medtronic patents and the one Company patent remaining in the first phase of the case (the "June 2013 ruling").

Both parties filed appeals to the U.S. Court of Appeals for the Federal Circuit. On March 2, 2015, the Court of Appeals issued a decision upholding the jury's findings of liability as to all patents, but overturning the damage award against the Company as improper ("March 2<sup>nd</sup> Court of Appeals Decision"). The case was remanded back to the District Court for further proceedings and a retrial to determine a proper damages award. Similarly, the U.S. Supreme Court granted Medtronic's appeal of liability with regard to the one Company patent at issue in Phase 1, and remanded the case back to the Court of Appeals for further consideration of Medtronic's liability in view of an intervening case from the Supreme Court. On June 3, 2016, the Court of Appeals affirmed Medtronic's liability regarding the one Company

patent. Further, on March 6, 2015, the Company sought reexamination of certain claims of one of the two Medtronic patents at issue in Phase 1 of the litigation and for which the Company was found to have infringed. On June 15, 2016, the District Court stayed the Phase 1 remand proceedings and retrial pending the reexamination. As of September 30, 2016, the claims of the Medtronic patent subject to reexamination stand rejected pursuant to a June 17, 2016 non-final office action.

As a result of the affirmation of the infringement and remand for a new trial on damages, the Company assessed the existing liability under the loss contingency framework and – in accordance with applicable accounting guidance – believed the most appropriate accrual estimate within the possible range dictated by such guidance was \$87.6 million. This amount represents liability for the infringement of the two Medtronic patents for infringing products at historically supplied rates from the date of infringement to the current period. The liability did not include an accrual for lost profits or convoyed products. A liability associated with this matter has been recorded in non-current litigation liabilities. In prior periods, the Company recorded the respective liabilities (as estimated) in non-current litigation liabilities and the accrued royalties in accrued liabilities. The Company did not agree with the previously-ruled royalty rates, and intended to rigorously pursue appropriate rates during the new trial on damages. Nonetheless, in the interim, the Company applied the previously-ruled royalty rates when calculating the appropriate estimate. As a result of the adjustment, the Company recorded an adjustment of \$56.4 million as a gain in its Consolidated Statements of Operations during the first quarter 2015.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On March 19, 2012, in connection with these proceedings, the Company entered into an escrow arrangement and transferred \$113.3 million of cash into a restricted escrow account to secure the amount of judgment, plus prejudgment interest, during pendency of the appeal. As a result of the March 2<sup>nd</sup> Court of Appeals Decision, the parties agreed to release all of the escrow funds related to this matter back to the Company. During the three months ended September 30, 2015, the Company transferred all of the funds in escrow related to this matter, approximately \$114.1 million, from long-term restricted cash and investments into its unrestricted investment accounts.

In accordance with the authoritative guidance on the evaluation of loss contingencies, during the year ended December 31, 2011, the Company recorded an accrual of \$101.2 million for the 2011 verdict. In addition, the Company accrued royalties at the royalty rates stated in the 2011 verdict on sales subsequent to the 2011 verdict and through March 31, 2013. After the June 2013 ruling, the Company (i) began accruing ongoing royalties on sales at the royalty rates stated in the June 2013 ruling, and (ii) recorded a charge of approximately \$7.9 million to account for the difference between using the royalty rates stated in the 2011 verdict and those in the June 2013 ruling on sales through March 31, 2013. Based on the June 2013 ruling, the Company agreed to escrow funds to secure accrued royalties as well as future ongoing royalties. However, in light of the March 2<sup>nd</sup> Court of Appeals Decision, escrowed funds were released to the Company. Additionally, the Company modified its accrual from the 2011 verdict as a result of the March 2<sup>nd</sup> Court of Appeals Decision as previously discussed.

With respect to the favorable verdict delivered regarding the one Company patent litigated to verdict, the jury awarded the Company monetary damages of approximately \$0.7 million for reasonable royalty damages. In accordance with the authoritative guidance on the evaluation of gain contingencies, this amount was not recorded at September 30, 2016. Additionally, the June 2013 ruling determined the ongoing royalty rate to be paid to the Company by Medtronic for its post-verdict sales of the one Company patent. Consistent with the treatment afforded the \$0.7 million damage award, no amount was recorded for royalty revenue as of September 30, 2016.

The second phase of the case involved one Medtronic cervical plate patent. On April 25, 2013, the Company and Medtronic entered into a settlement agreement fully resolving the second phase of the case (“2013 Settlement”). The settlement also removed from the case the cervical plate patent that was part of the first phase. As part of the settlement, the Company received a broad license to practice (i) the Medtronic patent that was the sole subject of the second phase of the litigation, (ii) the Medtronic cervical plate patent that was part of the first phase of the litigation, and (iii) each of the Medtronic patent families that collectively represent the vast majority of Medtronic’s patent rights related to cervical plate technology. In exchange for these license rights, the Company made a one-time payment to Medtronic of \$7.5 million. In addition, Medtronic will receive a royalty on certain cervical plate products sold by the Company, including the Helix and Gradient lines of products. As a result of this settlement, all current patent disputes between the parties related to cervical plate technology have been resolved.

In August 2012, Medtronic filed additional patent claims in the U.S. District Court for the Northern District of Indiana alleging that various Company spinal implants (including its CoRoent XL family of spinal implants) infringe Medtronic’s U.S. Patent No. 8,021,430, that the Company’s Osteocel Plus bone graft product infringes Medtronic’s U.S. Patent No. 5,676,146, (“146 Patent”) and that the Company’s XLIF procedure and use of MaXcess IV retractor during the XLIF procedure infringe methodology claims of Medtronic’s U.S. Patent No. 8,251,997. The case, which is

referred to herein as the third phase of the Medtronic litigation, was later transferred to the Southern District of California, and, on March 7, 2013, the Company counterclaimed alleging infringement by Medtronic of the Company's U.S. Patent Nos. 8,000,782 (systems and related methods for performing surgical procedures), 8,005,535 (systems and related methods for performing surgical procedures), 8,016,767 (a surgical access system including a tissue distraction assembly and a tissue retraction assembly), 8,192,356 (a system for accessing a surgical target site and related methods, involving an initial distraction system, among other things), 8,187,334 (spinal fusion implant), 8,361,156 (spinal fusion implant), D652,922 (dilator design) ("922 Patent"), and D666,294 (dilator design). On July 25, 2013, Medtronic amended its complaint to add a charge of infringement of its U.S. Patent No. 8,444,696. The District Court stayed litigation of a number of Medtronic and Company patents subjected to reexamination or review proceedings conducted by the Patent Office. Both parties brought motions for summary judgment addressing the patents that were not stayed or dismissed in the litigation, and summary judgment of non-infringement was granted as to both remaining patents on October 20, 2015 and February 17, 2016, respectively. No other patent claims are active in the third phase of the case. Before September 30, 2016, the probable outcome of this litigation could not be determined, nor could the Company estimate a range of potential loss. In accordance with the authoritative guidance on the evaluation of loss contingencies, the Company did not record an accrual related to this litigation.

Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On July 13, 2016, the Company entered into a settlement and patent license agreement (the “Settlement Agreement”) with Medtronic to settle the Medtronic Litigation. Under the terms of the Settlement Agreement, the Company paid Medtronic \$45.0 million, and the parties released each other from, inter alia, any and all past patent infringement arising from the Medtronic Litigation. As a result, the Company adjusted its litigation accrual from \$88.3 million to \$45.0 million and recorded a \$43.3 million gain in the Consolidated Statement of Operations for the nine months ended September 30, 2016. Associated with the gain on the litigation are certain service provider fees, the Company has recorded its obligations associated with the gain, however, it is reasonably possible the Company’s estimates could differ from those that have been recorded in the financial statements. Pursuant to the Settlement Agreement, the parties granted each other irrevocable, worldwide, nonexclusive, paid-up, royalty-free licenses to practice certain of their respective patents as to certain of their respective existing product lines, subject to specified exceptions and limitations. The Settlement Agreement also provides that, subject to certain limitations and exceptions, and for a period of seven years, neither party will assert against the other certain claims for patent infringement (generally claims related to spinal implants and related instruments, biologics and neuromonitoring) other than through a specified dispute resolution process, with the right to thereafter pursue claims outside that process subject to certain limitations and exceptions. Further, Medtronic has agreed that, for a period of five years, and subject to limitations and exceptions, it will not assert against the Company certain other claims for patent infringement other than through a specified dispute resolution process, with the right to thereafter pursue claims outside that process subject to certain limitations and exceptions.

Trademark Infringement Litigation

On September 25, 2009, Neurovision Medical Products, Inc. (“NMP”) filed suit against the Company in the U.S. District Court for the Central District of California (Case No. 2:09-cv-06988-R-JEM) alleging trademark infringement and unfair competition. NMP sought cancellation of NuVasive’s “NeuroVision” trademark registrations, injunctive relief and damages based on NMP’s common law use of the “NeuroVision” mark. The matter was tried in October 2010 and an unfavorable jury verdict was delivered against the Company. The verdict awarded damages to NMP of \$60.0 million, and the Company appealed the judgment. The Court of Appeals reversed and vacated the judgment, and a new trial was conducted in the District Court. In April 2014, a jury returned a verdict in favor of NMP on its claims against the Company in the amount of \$30.0 million. The District Court also entered an order canceling the Company’s NeuroVision trademark registrations. In July 2015, the Company agreed to settle all outstanding matters with NMP for \$27.2 million. The Company adjusted its litigation accrual from \$30.0 million to \$27.2 million at June 30, 2015, which resulted in a \$2.8 million gain which was recorded in the Consolidated Statement of Operations during the three months ended June 30, 2015. The Company previously escrowed funds totaling \$32.5 million to secure the amount of judgment, and cover potential attorney’s fees and costs. Those funds accrued interest and were included in short-term restricted cash and investments in the Consolidated Balance Sheets until funding of the settlement which occurred during the three months ended September 30, 2015. The Company no longer has any remaining liability or restricted cash related to this matter.

Securities Litigation

On August 28, 2013, a purported securities class action lawsuit was filed in the U.S. District Court for the Southern District of California naming the Company and certain of its current and former executive officers for allegedly making false and materially misleading statements regarding the Company's business and financial results, specifically relating to the purported improper submission of false claims to Medicare and Medicaid. The operative complaint asserts a putative class period stemming from October 22, 2008 to July 30, 2013. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder and seeks unspecified monetary relief, interest, and attorneys' fees. On February 13, 2014, Brad Mauss, the lead plaintiff in the case ("Plaintiff"), filed an Amended Class Action Complaint for Violations of the Federal Securities Laws. The District Court granted the Company's motion to dismiss the Amended Complaint and ordered Plaintiff to amend the complaint. Plaintiff filed a Second Amended Complaint on September 8, 2014, and the District Court once again granted the Company's motion to dismiss the complaint with leave to amend. On December 23, 2014, Plaintiff filed a Third Amended Complaint. The Company filed a motion to dismiss, and while the Company's motion was pending, Plaintiff sought leave to file a Fourth Amended Complaint. The Company moved to dismiss the Fourth Amended Complaint. On August 28, 2015, the District Court issued an order granting the Company's motion to dismiss the Fourth Amended Complaint with leave to amend. On September 11, 2015, Plaintiff filed a Fifth Amended Complaint, and in July 2016, the District Court issued an order rejecting the Company's motion to dismiss the Fifth Amended Complaint. The Company answered the Fifth Amended Complaint on August 25, 2016 and discovery is proceeding. Trial has been set for December 18, 2017. At September 30, 2016, the probable outcome of this litigation cannot be determined, nor can the Company estimate a range of potential loss. In accordance with authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this litigation.



Table of Contents

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Shareholder Derivative Litigation

On September 28, 2016, a shareholder derivative complaint was filed by James Borta in the Superior Court of California for the County of San Diego naming certain of the Company's current and former executive officers and directors for allegedly breaching their fiduciary duties by, among other things, making allegedly false and misleading statements about the Company's business, operations, and prospects. The derivative complaint is based upon the same factual allegations as the securities class action litigation and names the Company as a nominal defendant. The defendants have not yet responded to the complaint. At September 30, 2016, the probable outcome of this litigation cannot be determined, nor can the Company estimate a range of potential loss. In accordance with authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this litigation.

Madsen Medical, Inc. Litigation

On February 22, 2016, an unfavorable jury verdict was delivered against the Company in its litigation in the U.S. District Court for the Southern District of California against Madsen Medical, Inc. ("MMI"), a former sales agent. Specifically, the jury awarded MMI \$7.5 million in lost profits for tortious interference, \$14.0 million for unjust enrichment, \$20.0 million in punitive damages, and approximately \$0.3 million in damages for breach of contract. On March 18, 2016, the trial court entered judgment in favor of MMI in the amount of \$27.8 million, which amount excluded the \$14.0 million disgorgement awarded by the jury. On July 5, 2016, the trial court also awarded MMI attorney's fees and costs of approximately \$1.1 million. The Company's post-trial motions for judgment as a matter of law and/or for a new trial were denied, and the Company has filed a notice of appeal of both the verdict and the court's subsequent award of attorney's fees and costs. During pendency of any appeals, the Company has secured a bond to cover the amount of the judgment and attorneys' fees and costs.

Historically the Company had believed the likelihood of a loss in this case was remote given the underlying facts of the case, however, during the quarter ended March 31, 2016, the judgment entered caused the Company to reassess its position. The Company, based on its own assessment as well as that of outside counsel, believes that upon either post-trial motions or appeal the judgment will be vacated and have deemed it probable that is the outcome. The Company continues to believe that the judgment will be vacated, and accordingly, at September 30, 2016, the Company believes that the outcome of the case does not constitute a probable nor an estimable loss associated with the litigation but rather a reasonably possible loss rather than a remote loss as historically contemplated. Therefore, the Company has not recorded a loss contingency but has assessed a reasonable range of potential loss, which would be from zero to the current amount entered as a judgment, as well as attorney's fees and interest, in accordance with the accounting guidance required by ASC 450, Contingencies.

12. Regulatory Matters

In 2013, the Company received a federal administrative subpoena from the Office of the Inspector General of the U.S. Department of Health and Human Services ("OIG") in connection with an investigation into possible false or otherwise improper claims submitted to Medicare and Medicaid. The subpoena sought discovery of documents for the period January 2007 through April 2013. In July 2015, the Company entered into a definitive settlement agreement. Under

the terms of the agreement, the Company paid \$13.5 million plus fees and accrued interest of approximately \$0.3 million to resolve this matter. The settlement was not an admission of liability or wrongdoing by the Company, and the Company was not required to enter into a corporate integrity agreement with the OIG as part of the settlement. In accordance with the authoritative guidance on the evaluation of loss contingencies, the Company recorded a \$13.8 million litigation charge related to this matter, which was included in the Consolidated Statements of Operations and funded during the nine months ended September 30, 2015.

On August 31, 2015, the Company received a civil investigative demand (“CID”) issued by the DOJ pursuant to the federal False Claims Act. The CID requires the delivery of a wide range of documents and information related to an investigation by the DOJ concerning allegations that the Company assisted a physician group customer in submitting improper claims for reimbursement and made improper payments to the physician group in violation of the Anti-Kickback Statute. The Company is cooperating with the DOJ. No assurance can be given as to the timing or outcome of this investigation. At September 30, 2016, the probable outcome of this matter cannot be determined, nor can the Company estimate a range of potential loss. In accordance with authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this matter.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward-Looking Statements May Prove Inaccurate

This quarterly report on Form 10-Q ("Quarterly Report"), including the following discussion and analysis, may contain forward-looking statements that involve risks, uncertainties, assumptions and other factors which, if they do not materialize or prove correct, could cause our results to differ from historical results or those expressed or implied by such forward-looking statements. In some cases, you can identify these forward-looking statements by words like "may", "will", "should", "could", "expects", "plans", "anticipates", "believes", "estimates", "predicts", "potential", "intends" (the negative of those words and other comparable words). Forward-looking statements include, but are not limited to, statements about:

- our intentions, beliefs and expectations regarding our expenses, sales, operations and future financial performance;
- our operating results;
- our plans for future products and enhancements of existing products;
- anticipated growth and trends in our business;
- the timing of and our ability to maintain and obtain regulatory clearances or approvals;
- our belief that our cash and cash equivalents and investments will be sufficient to satisfy our anticipated cash requirements;
- our expectations regarding our revenues, customers and distributors;
- our beliefs and expectations regarding our market penetration and expansion efforts;
- our expectations regarding the benefits and integration of recently-acquired businesses and our ability to make future acquisitions and successfully integrate any such future-acquired businesses;
- our anticipated trends and challenges in the markets in which we operate; and
- our expectations and beliefs regarding and the impact of investigations, claims and litigation.

These statements are not guarantees of future performance or events. Our actual results may differ materially from those discussed here. The potential risks and uncertainties that could cause actual results to differ materially include, but are not limited to those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015, and similar discussions in our other Securities and Exchange Commission filings. We assume no obligation to update any forward looking statements to reflect new information, future events or circumstances or otherwise.

This information should be read in conjunction with the consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2015 contained in our 2015 Annual Report on Form 10-K.

## Table of Contents

### Overview

We are a leading medical device company in the global spine surgery market, focused on developing minimally-disruptive surgical products and procedurally-integrated solutions for spine surgery. Our currently-marketed product portfolio is focused on applications for spine fusion surgery, including corrective spinal alignment and other surgical support and services used to aid in spine surgery procedures.

Our principal product offering includes a minimally-disruptive surgical platform called Maximum Access Surgery, or MAS. The MAS platform combines three categories of solutions that collectively minimize soft tissue disruption during spine fusion surgery, provide maximum visualization and are designed to enable safe and reproducible outcomes for the surgeon and the patient. The platform includes our proprietary software-driven nerve detection and avoidance systems, and Intraoperative Monitoring, or IOM, services and support; MaXcess, an integrated split-blade retractor system; and a wide variety of specialized implants and biologics. Many of our products, including the individual components of our MAS platform can also be used in open or traditional spine surgery. Our spine surgery product line offerings, which include products for the thoracolumbar and the cervical spine, are primarily used to enable surgeon access to the spine to perform restorative and fusion procedures in a minimally-disruptive fashion. We also recently launched Integrated Global Alignment, or iGA, in which products and computer assisted technology under our MAS platform help achieve more precise spinal alignment. Our biologics products, which are used to aid in the spinal fusion process or bone healing process, include allograft (donated human tissue) and synthetic offerings.

In addition, on February 11, 2016 we acquired Ellipse Technologies, Inc., or Ellipse Technologies, which now operates as our wholly owned subsidiary under the renamed legal entity NuVasive Specialized Orthopedics, Inc., or NSO. NSO designs and sells expandable growing rod implant systems that can be non-invasively lengthening following implantation with precise, incremental adjustments via an external remote controller using magnetic technology called MAGnetic External Control, or MAGEC. The technology platform provides the basis of NSO's core product offerings, including MAGEC-EOS, which allows for the minimally invasive treatment of early-onset and adolescent scoliosis, as well as the PRECICE limb lengthening system, which allows for the correction of long bone limb length discrepancy, as well as enhanced bone healing in patients that have experienced traumatic injury. We continue to focus significant research and development efforts to expand our MAS product platform and additional applications of the MAGEC technology to advance the applications of our unique technology into procedurally-integrated surgical solutions that improve clinical and economic outcomes. Such applications include tumor, trauma, and deformity, as well as increased fixation options and sagittal alignment products.

We intend to continually expand our product and service offerings as we execute on our strategy to offer customers an end-to-end, integrated procedural solution for spine surgery. We have dedicated and continue to dedicate significant resources toward training spine surgeons around the world; both those who are new to our MAS product platform, as well as ongoing education for MAS-trained surgeons attending advanced courses.

### Revenues and Operations

To date, the majority of our revenues are derived from the sale of implants, biologics and disposables and we expect this trend to continue for the foreseeable future. Additionally, following the closing of the acquisition of BNN Holdings Corp. on July 1, 2016, we expect our IOM service and support revenue to increase compared to previous

periods. We loan our proprietary software-driven nerve monitoring systems and surgical instrument sets at no cost to surgeons and hospitals that purchase disposables and implants for use in individual procedures. In addition, we often place our proprietary software-driven nerve monitoring systems, MaXcess and other MAS instrument sets with hospitals for an extended period at no up-front cost to them. Our implants, biologics and disposables are currently sold and shipped from our distribution and warehousing operations. We generally recognize revenue for implants, biologics and disposables upon receiving acknowledgement of a purchase order and upon completion of delivery. We sell MAS instrument sets, MaXcess devices, and our proprietary software-driven nerve monitoring systems, however this does not make up a material part of our business.

The majority of our operations are located and the majority of our sales have been generated in the United States. We sell our products in the United States through a sales force comprised primarily of exclusive independent sales agents and directly-employed sales representatives, both engaged to sell only NuVasive products. Our sales force provides a delivery and consultative service to our surgeon and hospital customers and is compensated based on sales and product placements in their territories. Sales force commissions are reflected in the sales, marketing and administrative operating expense line item within our statement of operations. We are continuing to invest in our expansion of international sales efforts with the focus on European, Asia-Pacific and Latin American markets. Our international sales force is comprised of directly-employed sales representatives as well as exclusive distributors and independent sales agents.

Table of Contents

## Results of Operations

## Revenue

	September 30,		\$		
(in thousands, except %)	2016	2015	Change	% Change	
<b>Three Months Ended</b>					
<b>Revenue</b>					
Spinal Hardware	\$162,831	\$138,948	\$23,883	17	%
Surgical Support	76,818	61,590	15,228	25	%
<b>Total revenue</b>	<b>\$239,649</b>	<b>\$200,538</b>	<b>\$39,111</b>	<b>20</b>	<b>%</b>
<b>Nine Months Ended</b>					
<b>Revenue</b>					
Spinal Hardware	\$486,030	\$410,225	\$75,805	18	%
Surgical Support	204,933	185,606	19,327	10	%
<b>Total revenue</b>	<b>\$690,963</b>	<b>\$595,831</b>	<b>\$95,132</b>	<b>16</b>	<b>%</b>

Our spinal hardware product line offerings include our implants and fixation products, and following the acquisition of Ellipse Technologies, include the MAGEC-EOS spinal bracing and lengthening system and the PRECICE limb lengthening system. Our surgical support product line offerings include IOM services, disposables and biologics, all of which are used to aid spinal surgery.

The continued adoption of minimally invasive procedures for spine has led to the expansion of our procedure volume. In addition, increased market acceptance in our international markets contributed to the increase in revenues for the periods presented. We expect continued adoption of our innovative minimally invasive procedures and deeper penetration into existing accounts and international markets as our sales force executes on our strategy of selling the full mix of our products and services. However, the continued consolidation and increased purchasing power of our hospital customers and group purchasing organizations, the continued existence of physician-owned distributorships, recent changes in the public and private insurance markets regarding reimbursement, and ongoing policy and legislative changes in the United States have created less predictability in the lumbar portion of the spine market and have limited the domestic spine market's procedural growth rate. Accordingly, we believe that our growth in revenue in 2016 will come primarily from share gains in the shift toward less invasive spinal surgery, revenue from newly acquired products and services, and international growth.

Revenue from our spinal hardware product line offerings increased \$23.9 million and \$75.8 million, or 17% and 18%, during the three and nine months ended September 30, 2016, respectively, compared to the same period in 2015. Revenue associated with our 2016 acquisitions accounted for approximately 11% and 9% of the increase in spinal hardware revenue for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. Product volume for our business, excluding 2016 acquisitions, increased our revenue by approximately 6% and 11% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. These increases were partially offset by unfavorable pricing changes of approximately 1% and 1.5%, for the three and nine months ended September 30, 2016, respectively. Foreign currency fluctuation had an insignificant impact on revenue from spinal hardware for the periods presented.

Revenue from our surgical support product line offerings increased \$15.2 million and \$19.3 million, or 25% and 10%, during the three and nine months ended September 30, 2016, respectively, compared to the same period in 2015. Revenue associated with our acquisitions during 2016 accounted for approximately 23% and 8% of the increase in surgical support revenue for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. Product volume for our business, excluding 2016 acquisitions, increased our revenue by approximately 2% and 3% for the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. Pricing changes had an insignificant impact on the change in revenue for the three and nine months ended September 30, 2016 compared to the same period in 2015.

Table of Contents

## Cost of Goods Sold, Excluding Below Amortization of Intangible Assets

(in thousands, except %)	September 30,		\$ Change	% Change	
	2016	2015			
<b>Three Months Ended</b>					
Cost of goods sold (excluding below amortization of intangible assets)	\$59,196	\$49,167	\$10,029	20	%
% of total revenue	25	% 25	%		
<b>Nine Months Ended</b>					
Cost of goods sold (excluding below amortization of intangible assets)	\$173,167	\$143,246	\$29,921	21	%
% of total revenue	25	% 24	%		

Cost of goods sold consists primarily of raw materials, labor and overhead associated with product manufacturing, purchased goods, inventory-related costs and royalty expense, as well as the cost of providing IOM services, which includes personnel and physician oversight costs. We primarily procure and manufacture our goods in the United States, and accordingly, foreign currency fluctuations have not materially impacted our cost of goods sold.

Cost of goods sold increased \$10.0 million, or 20%, and \$29.9 million, or 21% during the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. Cost of goods sold for our business, excluding our 2016 acquisitions, increased as a result of the growth in volume, slightly offset with favorable shifts in price, for an overall increase of approximately 9% and 11% for the three and nine months ended September 30, 2016, respectively. Inventory expense associated with the purchase accounting for our acquisition of Ellipse Technologies accounted for approximately 5% and 10% of the total increase for the three and nine months ended September 30, 2016, respectively. The cost of goods sold associated with the operations of our 2016 acquisitions accounted for approximately 23% and 10% of the total increase for the three and nine months ended September 30, 2016, respectively. The overall increases in cost of goods sold were partially offset by decreases in other cost of goods sold expenses of approximately 17% and 10% for the three and nine months ended September 30, 2016, respectively, related to reductions in costs from the repeal of the Affordable Care Act's medical device tax in 2016, expiring royalty obligations for certain product lines, and other non-recurring inventory related items. Cost of goods sold as a percentage of revenue remained relatively consistent; experiencing a 1% decrease in gross margin for the nine months ended September 30, 2016, compared to the same period in 2015, for the reasons described above.

On a long-term basis, we expect cost of goods sold, as a percentage of revenue, to decrease moderately.

## Operating Expenses

(in thousands, except %)	Three Months Ended September 30, 2016		Three Months Ended September 30, 2015		\$ Change	% Change
	Operating expense	% of revenue	Operating expense	% of revenue		



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Sales, marketing and administrative	\$ 131,886	55	%	\$ 110,554	55	%	\$ 21,332	19	%
Research and development	12,516	5	%	9,189	5	%	3,327	36	%
Amortization of intangible assets	11,438	5	%	3,067	2	%	8,371	273	%
Litigation liability (gain)	—	—	%	(500 )	—	%	500	100	%
Business transition costs	3,451	1	%	950	—	%	2,501	263	%

(in thousands, except %)	Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015			\$ Change	% Change	
	Operating expense	% of revenue		Operating expense	% of revenue				
Sales, marketing and administrative	\$391,211	57	%	\$338,444	57	%	\$52,767	16	%
Research and development	35,016	5	%	27,227	5	%	7,789	29	%
Amortization of intangible assets	29,912	4	%	9,037	2	%	20,875	231	%
Litigation liability (gain)	(43,310 )	6	%	(42,507 )	7	%	(803 )	2	%
Business transition costs	11,514	2	%	10,845	2	%	669	6	%

## Table of Contents

### Sales, Marketing and Administrative

Sales, marketing and administrative expenses consist primarily of compensation costs, commissions and training costs for shareowners engaged in sales, marketing and customer support functions. The expense also includes distributor commissions, freight expenses, surgeon training costs, depreciation expense for property and equipment such as surgical instrument sets, and administrative expenses for both shareowners and third party service providers.

Sales, marketing and administrative expenses increased \$21.3 million or 19% and \$52.8 million or 16% during the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015, primarily related to increases in shareowner compensation due to increased headcount, and costs which increase as a function of the increase in revenue and international expansion such as distributor commissions and freight. Sales, marketing and administrative expenses associated with our acquisitions in 2016 accounted for approximately 13% and 11% of the increase in sales, marketing and administrative expenses for the three and nine months ended September 30, 2016, respectively.

As a percentage of revenue, sales, marketing and administrative expenses remained consistent during the three and nine months ended September 30, 2016 compared to the same periods in 2015. On a long-term basis, we expect total sales, marketing and administrative costs, as a percentage of revenue, to decrease moderately. However, during the current period there have been increased costs associated with acquisitions and related activities. To date, foreign currency fluctuations have not materially impacted our sales, marketing, and administrative expense.

### Research and Development

Research and development expense consists primarily of product research and development, clinical trial and study costs, regulatory and clinical functions, and compensation and other shareowner related expenses. In the last several years, we have introduced numerous new products and product enhancements that have significantly expanded our MAS platform, including iGA, and our comprehensive product portfolio. We have also acquired complementary and strategic assets and technology, particularly in the area of spinal hardware products. We continue to invest in research and development programs.

Research and development expense increased by \$3.3 million or 36% and \$7.8 million or 29% during the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015. The increase in spending is primarily due to product related expenses associated with NSO, as well as increased spending for our other technologies.

Research and development costs as a percentage of revenue have remained relatively consistent throughout the three and nine months ended September 30, 2016 compared to the same period in 2015. However, on a long-term basis, excluding unique items, we expect total research and development costs as a percentage of revenue to increase moderately in support of our ongoing development and regulatory approval efforts.

### Litigation Liability Gain (Loss)

During the nine months ended September 30, 2016, we settled our ongoing litigation with Medtronic. As a result of the settlement, we recorded a gain of \$43.3 million related to the settlement. Litigation liability gain of \$42.5 million for the nine months ended September 30, 2015 primarily related to the recognition of a \$56.4 million gain stemming from a favorable appeal in Phase 1 of the Medtronic litigation, which revised the award for lost profits and conveyed sales, and a gain of \$2.8 million in litigation accrual change related to the settlement of the NeuroVision trademark litigation reducing the accrual from \$30.0 million to \$27.2 million. The litigation liability gains were partially offset by litigation liability losses of \$13.8 million in connection with the OIG investigation and \$2.8 million in a general litigation matter. See Note 11 to the Unaudited Consolidated Financial Statements for further discussion.

#### Interest and Other Expense, Net

Total interest expense increased \$3.7 million and \$8.3 million during the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015 as a result of issuance of the 2021 Senior Convertible Notes in March 2016. Additionally, a loss of \$17.4 million was recognized in March 2016 on the repurchases of \$276.8 million principal amount of the outstanding 2017 Senior Convertible Notes, which was recorded in other expense. Other income, net, includes foreign currency exchange and derivative instrument gains (losses) of \$0.1 million and \$(0.1) million, net of foreign currency hedges during the three and nine months ended September 30, 2016, respectively, and \$0.4 million during the three and nine months ended September 30, 2015. Our currency exposures vary, but are primarily concentrated in the pound sterling, the euro, the Australian dollar, the Singapore dollar, and the yen. The total interest and other expense, net, included marginal income earned on marketable securities.

Table of Contents

## Income Tax Expense

	September 30,	
(in thousands, except %)	2016	2015
<b>Three Months Ended</b>		
Income tax expense	\$6,972	\$8,803
Effective income tax rate	67 %	41 %
<b>Nine Months Ended</b>		
Income tax expense	\$17,383	\$35,332
Effective income tax rate	37 %	39 %

Income tax expense as a percentage of income before income taxes was 67% for the three months ended September 30, 2016 compared with 41% for the three months ended September 30, 2015. The higher effective income tax rate for the three months ended September 30, 2016 was primarily due to the mix of earnings for the three months ended September 30, 2016 compared to the mix of earnings for the three months ended September 30, 2015, and a one-time release in valuation allowances during the three months ended September 30, 2015.

Income tax expense as a percentage of income before income taxes was 37% for the nine months ended September 30, 2016 compared with 39% for the nine months ended September 30, 2015. The lower effective income tax rate for 2016 was primarily due to increased research credits and current year income tax benefits related to excess share-based compensation payments as a result of adopting ASU 2016-09 as of January 1, 2016, offset by larger 2015 tax benefits associated with the release of valuation allowances and tax reserves on certain executive compensation deductions. See Note 1 to Unaudited Consolidated Financial Statements for further information regarding the early adoption of ASU 2016-09 and its impacts to our financials.

## Liquidity, Cash Flows and Capital Resources

## Liquidity and Capital Resources

Our principal sources of liquidity are our existing cash, cash equivalents and marketable securities, cash generated from operations, proceeds from our convertible notes issuances, and access to our revolving line of credit. We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, working capital requirements and capital deployment decisions. We have historically invested our cash primarily in the U.S. treasuries and government agencies, corporate debt, and money market funds. Certain of these investments are subject to general credit, liquidity and other market risks. The general condition of the financial markets and an economy may increase those risks and may affect the value and liquidity of our current investments and restrict our ability to access the capital markets.

Our future capital requirements will depend on many factors including our rate of revenue growth, the timing and extent of spending to support development efforts, the expansion of sales, marketing and administrative activities, the timing of introductions of new products and enhancements to existing products, successful vertical integration of our manufacturing process, the continuing market acceptance of our products, the expenditures associated with possible future acquisitions or other business combination transactions, the outcome of current and future litigation, the evolution of our globalization initiative, and continuous international expansions of our business. We believe that our

cash flow from operations and growing operations will continue to fund the ongoing core business. As current borrowing sources become due, we may be required to access the capital markets for additional funding. As we assess inorganic growth strategies, we may need to supplement our internally generated cash flow with outside sources.

A substantial portion of our operations are located in the United States, and the majority of our sales and cash generation since inception have been made in the United States. Accordingly, we do not have material net cash flow exposures to foreign currency rate fluctuations. However, as our business in markets outside of the United States continues to increase, we will be exposed to foreign currency exchange risk related to our foreign operations. Fluctuations in the rate of exchange between the United States dollar and foreign currencies, primarily in the pound sterling, the euro, the Australian dollar, the Singapore dollar, and the yen, could adversely affect our financial results, including our revenues, revenue growth rates, gross margins, income and losses as well as assets and liabilities. We enter into forward currency contracts to partially offset the impact from fluctuations of the foreign currency rates on our third party and short-term intercompany receivables and payables between our domestic and international operations. At September 30, 2016, the cash balance held by our foreign subsidiaries with currencies other than the United States dollar was approximately \$27.9 million and it is our intention to indefinitely reinvest all of current foreign earnings in order to partially support foreign working capital and to expand our existing operations outside the United States. As of September 30, 2016, our account receivable balance held by our foreign subsidiaries with currencies other than the United States dollar was approximately \$21.8 million. We have operations in markets in which there is governmental instability which could impact funds that flow into the medical reimbursement system. In addition, loss of financial stability within these markets could lead to delays in reimbursement or inability to remit payment due to currency controls. Specifically, we have operations and/or sales in Puerto Rico, Brazil, Argentina and Venezuela. We do not have any material financial exposure to one customer or one country that would significantly hinder our liquidity.

Table of Contents

During the nine months ended September 30, 2016, we settled and paid our ongoing litigation with Medtronic for \$45.0 million, which resulted in a gain of \$43.3 million as we eliminated our previous accrual of \$88.3 million related to this matter. See Note 11 to the Unaudited Consolidated Financial Statements for further discussion.

On August 31, 2015, we received a civil investigative demand, or CID, issued by the Department of Justice, or DOJ, pursuant to the federal False Claims Act. The CID requires the delivery of a wide range of documents and information related to an investigation by the DOJ concerning allegations that we assisted a physician group customer in submitting improper claims for reimbursement and made improper payments to the physician group in violation of the Anti-Kickback Statute. We are cooperating with the DOJ. No assurance can be given as to the timing or outcome of this investigation, and the probable outcome of this matter cannot be determined.

We are involved in a number of legal actions and investigations arising out of the normal course of our business as discussed in Note 11 of the Unaudited Consolidated Financial Statements. Due to the inherent uncertainties associated with pending legal actions and investigations, we cannot predict the outcome, and, with respect to certain pending litigation or claims where no liability has been accrued, to make a meaningful estimate of the reasonably possible loss or range of loss that could result from an unfavorable outcome, other than those matters disclosed in this Quarterly Report. We have no material accruals for pending litigation or claims for which accrual amounts are not disclosed in our Unaudited Consolidated Financial Statements. It is reasonably possible, however, that an unfavorable outcome that exceeds our current accrual estimate, if any, for one or more of the matters described in our Unaudited Consolidated Financial Statements could have a material adverse effect on our liquidity and access to capital resources. Additionally, it is possible that as part of the ongoing legal appeals process, regardless of our assessment of the probability of a loss, we could be required to set aside funds in an escrow or purchase a performance bond. These requirements to escrow funding could have an adverse impact on our ability to access our current liquidity or impact our access to additional capital resources.

We currently have \$125.7 million in principal outstanding of senior convertible notes that will mature on July 1, 2017. Holders of the notes may elect to convert at any time beginning January 1, 2017. It is our intent to settle all conversions through combination settlement, whereby we would repay the principal amount in cash and the excess conversion value in shares of common stock. At September 30, 2016, a minimal amount of holders of the 2017 Notes had elected to convert for which the Company will settle in the fourth quarter 2016 through combination settlement. Refer to the below section subtitled “2.75% Senior Convertible Notes due 2017” for further details.

On September 12, 2016, we completed an acquisition of an imaging software and technology platform known as Lessray, for which the Company recorded a preliminary purchase accounting fair value estimate for \$36.0 million of contingent consideration liabilities related to the achievement of certain regulatory and commercial milestones, which we anticipate will become payable at varying times between 2017 and 2020. We expect the imaging software and technology platform to be incorporated into our MAS platform to form a foundational element in our imaging, navigation and automation platform development strategy.

On July 1, 2016, we completed our acquisition of BNN Holdings Corp. for an upfront payment of \$98.0 million, which was funded through cash and investments on hand. In connection with the closing, we used approximately \$92.1 million (net of cash acquired and amounts retained for acquired provisional obligations) of our available cash and investments on hand to pay the upfront payment to security holders of BNN Holdings Corp., as well as related

transaction fees and expenses.

On February 11, 2016, we acquired Ellipse Technologies for an upfront payment of \$380.0 million (including holdbacks for retained employment of Ellipse Technologies leadership that is to be expensed and is not considered part of the final purchase price) and a potential milestone payment of \$30.0 million payable in 2017 related to the achievement of specific revenue targets. In connection with the closing, we used approximately \$380.7 million (net of cash acquired) of our available cash and investments on hand to pay the upfront payment to security holders of Ellipse Technologies, as well as related transaction fees and expenses.

In furtherance of our initiative to increase the amount of products that we self-manufacture, in 2015 we added a manufacturing facility in Dayton, Ohio of approximately 179,000 square feet and announced our plans to build out and equip the new facility in order to expand our internal manufacturing efforts.

37

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Table of Contents

Cash, cash equivalents and marketable securities were \$203.8 million and \$470.1 million at September 30, 2016 and December 31, 2015, respectively. We believe that our existing cash, cash equivalents, marketable securities and available liquidity will be sufficient to meet our anticipated cash needs for the next 12 months. We could have varying needs for cash as a result of the achievement of certain acquisition related milestones. We anticipate funding these milestones from cash on hand and operations, however, we have the ability to fund these from our existing line of credit if necessary. The change in liquidity during the nine months ended September 30, 2016 of \$266.3 million was mainly driven by the funding of our acquisition of Ellipse Technologies of approximately \$380.1 million (net of cash acquired), \$343.8 million repurchase of a portion of our Senior Convertible Notes due 2017, \$92.1 million (net of cash acquired and amounts retained for acquired provisional obligations) for the acquisition of BNN Holdings Corp., \$66.3 million net for the call spread on the sale and purchase of warrants and bond hedge, \$24.4 million cash tax payments on behalf of shareowners with net share settlement, and ordinary seasonal payments such as annual bonuses, offset by inflows of \$634.1 million net issuance of our Senior Convertible Notes due 2021 and cash flow from operations. At September 30, 2016, we have cash totaling \$7.4 million in restricted accounts which are not available to us to meet any ongoing capital requirements if and when needed. Future litigation or requirements to escrow funds could materially impact our liquidity and our ability to invest in and run our business on an ongoing basis.

Cash Flows from Operating Activities

Cash provided by operating activities was \$96.0 million for the nine months ended September 30, 2016, compared to \$48.0 million for the same period in 2015. The \$48.0 million increase in cash provided by operating activities was primarily due to income tax payments in the prior year shifting to income tax refunds in the current year.

Cash Flows from Investing Activities

Cash used in investing activities was \$290.0 million for the nine months ended September 30, 2016, compared to \$19.3 million used for the same period in 2015. The \$270.7 million increase in cash used in investing activities was primarily due to the \$380.1 million cash payment (net of cash received) to fund the acquisition of Ellipse Technologies, the \$92.1 million cash payment (net of cash acquired and amounts retained for acquired provisional obligations) for the acquisition of BNN Holdings Corp., and \$22.0 million used in other acquisition related investments including purchases of intangible assets. The funding of the Ellipse Technologies acquisition was partially offset by a net increase of \$278.1 million cash received related to activities within investment portfolios over the periods presented.

Cash Flows from Financing Activities

Cash provided by financing activities was \$204.5 million for the nine months ended September 30, 2016, compared to \$29.0 million cash used for the same period in 2015. The \$233.5 million increase in cash provided by financing activities was primarily due to the net issuance of the 2021 Senior Convertible Notes of \$634.1 million, offset by the net \$66.3 million purchase of a call spread related to that issuance. Additionally, we used approximately \$343.8 million of the net proceeds to repurchase a portion of the 2017 Senior Convertible Notes.

Treasury stock purchases decreased \$28.1 million due to a decrease in equity award vesting and stock option exercises during the nine months ended September 30, 2016 compared to the same period in 2015. We use net share settlement



on stock issuances, which results in cash tax payments we make on behalf of shareowners and a decrease in the cash receipt from the issuance of common stock upon the exercising of stock options. Net share settlement is generally used in lieu of cash payments by shareowners for minimum tax withholding or exercise costs for equity awards. The net share settlement is accounted for as a treasury share repurchase transaction, with the cost of any deemed repurchased shares included in treasury stock and reported as a reduction in total equity at the time of settlement. Additionally, net share settlement for tax withholding requires us to fund a significant amount of cash for certain tax payment obligations from time-to-time with respect to the shareowner tax obligations for vested equity awards. We anticipate using cash generated from operating activities to fund such payments.

Table of Contents

Senior Convertible Notes

2.25% Senior Convertible Notes due 2021

In March 2016, we issued \$650.0 million principal amount of unsecured Senior Convertible Notes with a stated interest rate of 2.25% and a maturity date of March 15, 2021, which we refer to as the 2021 Notes. The net proceeds from the offering, after deducting initial purchasers' discounts and costs directly related to the offering, were approximately \$634.1 million. Interest on the 2021 Notes began accruing upon issuance and is payable semi-annually. The 2021 Notes may be settled in cash, stock, or a combination thereof, solely at our discretion. It is our current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of our common stock. The initial conversion rate of the 2021 Notes is 16.7158 shares per \$1,000 principal amount, which is equivalent to a conversion price of approximately \$59.82 per share, subject to adjustments. Prior to September 15, 2020, holders may convert their 2021 Notes only under the following conditions: (a) during any calendar quarter beginning June 30, 2016, if the reported sale price of our common stock for at least 20 days out of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than 130% of the conversion price on each applicable trading day; (b) during the five business day period in which the trading price of the 2021 Notes falls below 98% of the product of (i) the last reported sale price of our common stock and (ii) the conversion rate on that date; and (c) upon the occurrence of specified corporate events, as defined in the 2021 Notes. From September 15, 2020 and until the close of business on the second scheduled trading day immediately preceding March 15, 2021, holders may convert their 2021 Notes at any time (regardless of the foregoing circumstances). We may not redeem the 2021 Notes prior to March 20, 2019. We may redeem the 2021 Notes, at our option, in whole or in part on or after March 20, 2019 until the close of business on the business day immediately preceding September 15, 2020 if the last reported sale price of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which we deliver written notice of a redemption. The redemption price will be equal to 100% of the principal amount of such 2021 Notes to be redeemed plus accrued and unpaid interest to, but excluding, the redemption date. No principal payments are due on the 2021 Notes prior to maturity. Other than restrictions relating to certain fundamental changes and consolidations, mergers or asset sales and customary anti-dilution adjustments, the 2021 Notes do not contain any financial covenants and do not restrict us from paying dividends or issuing or repurchasing any of our other securities. We are unaware of any current events or market conditions that would allow holders to convert the 2021 Notes. The impact of the convertible feature will be dilutive to our earnings per share when our stock price average for the period is greater than the conversion price.

In connection with the offering of the 2021 Notes, we entered into the hedge transactions, which we refer to as the 2021 Hedge, with the initial purchasers and/or their affiliates, which we refer to as the 2021 Counterparties, entitling us to purchase up to 10,865,270 shares of our own common stock at an initial stock price of \$59.82 per share, each of which is subject to adjustment. The cost of the 2021 Hedge was \$111.2 million. The 2021 Hedge will expire on March 15, 2021. The 2021 Hedge is expected to reduce the potential equity dilution upon conversion of the 2021 Notes if the daily volume-weighted average price per share of our common stock exceeds the strike price of the 2021 Hedge. Our assumed exercise of the 2021 Hedge is considered anti-dilutive since the effect of the inclusion would always be anti-dilutive with respect to the calculation of diluted earnings per share.

We also sold warrants, which we refer to as the 2021 Warrants, to the 2021 Counterparties to acquire up to 10,865,270 common shares of our stock. The 2021 Warrants will expire on various dates from June 2021 through December 2021 and may be settled in cash or net shares. It is our current intent and policy to settle all conversions in shares of our common stock. We received \$44.9 million in cash proceeds from the sale of the 2021 Warrants. The 2021 Warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock during a given measurement period exceeds the strike price of the 2021 Warrants, which is \$80.00 per share.

Table of Contents*2.75% Senior Convertible Notes due 2017*

In June 2011, we issued \$402.5 million principal amount of Senior Convertible Notes, which we refer to as the 2017 Notes, with a stated interest rate of 2.75% and a maturity date of July 1, 2017. The net proceeds from the offering, after deducting initial purchasers' discounts and costs directly related to the offering, were approximately \$359.2 million. The 2017 Notes may be settled in cash, stock, or a combination thereof, solely at our discretion. It is our current intent and policy to settle all conversions through combination settlement, which involves repayment of an amount of cash equal to the principal amount and any excess of the conversion value over the principal amount in shares of common stock. The initial conversion rate of the 2017 Notes is 23.7344 shares per \$1,000 principal amount, or equivalent to conversion price of approximately \$42.13 per share, which is subject to adjustment. Beginning January 1, 2017 and until the close of business on the second scheduled trading day immediately preceding July 1, 2017, holders may convert their 2017 Notes at any time. Prior to January 1, 2017, holders may convert their 2017 Notes only under the conditions as described in Note 6 to the Unaudited Consolidated Financial Statements, which includes our common stock trading at 130% of the conversion price for 20 out of 30 consecutive trading days. It is our current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of our common stock. The impact of the convertible feature will be dilutive to our earnings per share when our stock price average for the period is greater than the conversion price. Interest on the 2017 Notes began accruing upon issuance and is payable semi-annually on January 1st and July 1st each year. At September 30, 2016, holders of the 2017 Notes were in a convertible position, as the reported sale price of the Company's common stock for 20 days out of the last 30 consecutive trading days ending with September 30, 2016 exceeded 130% of the \$42.13 per share conversion price on each applicable trading day. At September 30, 2016, a minimal amount of holders of the 2017 Notes had elected to convert their notes. We will settle such conversion in the fourth quarter 2016 through the combination settlement described above. The 2017 Notes are recorded as current liabilities on the September 30, 2016 consolidated balance sheet.

In connection with the offering of the 2017 Notes, we entered into convertible note hedge transactions, which we refer to as the 2017 Hedge, with the initial purchasers and/or their affiliates, which we refer to as the Counterparties, entitling us to purchase up to 9,553,096 shares of our common stock at an initial stock price of \$42.13 per share, each of which is subject to adjustment. The cost of the 2017 Hedge was \$80.1 million. The 2017 Hedge expires on July 1, 2017. The 2017 Hedge is expected to reduce the potential equity dilution upon conversion of the 2017 Notes if the daily volume-weighted average price per share of our common stock exceeds the strike price of the 2017 Hedge. Our assumed exercise of the 2017 Hedge is considered anti-dilutive since the effect of the inclusion would always be anti-dilutive with respect to the calculation of diluted earnings per share.

In addition, we sold warrants, which we refer to as the 2017 Warrants, to the Counterparties to acquire up to 477,654 shares of our Series A Participating Preferred Stock, at an initial strike price of \$988.51 per share, subject to adjustment. Each share of Series A Participating Preferred Stock is initially convertible into 20 shares of our common stock. The 2017 Warrants expire on various dates from September 2017 through January 2018 and may be settled in cash or net shares. It is our current intent and policy to settle all conversions in shares of our common stock, should the conversion occur. We received \$47.9 million in cash proceeds from the sale of the 2017 Warrants. The 2017 Warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock during a given measurement period (the quarter or year-to-date period) exceeds the strike price of the 2017 Warrants.

In March 2016, we used approximately \$345.2 million of the net proceeds from the 2021 Notes offering to repurchase approximately \$276.8 million in principal amount outstanding of the \$402.5 million 2017 Notes. The repurchase of a portion of the 2017 Notes resulted in a remaining balance of \$125.7 million in principal outstanding as of September 30, 2016.

#### Revolving Senior Credit Facility

In February 2016, we entered into a credit agreement, which we refer to as the Credit Agreement, for a revolving senior credit facility, which we refer to as the Facility, that provides for secured revolving loans, multicurrency loan options and letters of credit in an aggregate amount of up to \$150.0 million. The Credit Agreement also contains an expansion feature, which allows us to increase the aggregate principal amount of the Facility provided we remain in compliance with the underlying financial covenants. The Facility matures on February 8, 2021, and includes a sub-limit of \$15.0 million for letters of credit and a sub-limit of \$5.0 million for swing line loans. All of our assets and assets of our material domestic subsidiaries are pledged as collateral under the Facility (subject to customary exceptions) pursuant to the term set forth in the Security and Pledge Agreement executed in favor of the administrative agent by the Company. Each of our material domestic subsidiaries guarantees the Facility. At September 30, 2016 we did not carry any outstanding revolving loan under the Facility.

Borrowings under the Facility are used by us to provide financing for working capital and other general corporate purposes, including potential mergers and acquisitions. Loans under the Facility bear interest, at our option, at either LIBOR (determined in accordance with the Credit Agreement) plus an applicable margin ranging from 1.00 % - 2.00 % per annum subject to our applicable consolidated leverage ratio or the Base Rate (determined in accordance with the Credit Agreement), plus an applicable margin ranging from 0.0% - 1.25% per annum subject to our applicable consolidated leverage ratio. The Facility has a commitment fee, which accrues at a rate of 0.2% - 0.4% per annum (determined in accordance with the Credit Agreement) based on our current leverage ratio.

Table of Contents

The Credit Agreement contains affirmative, negative and financial covenants, and events of default customary for financings of this type. The financial covenants require us to maintain ratios of consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) to consolidated interest expense, and to consolidated debt, respectively, as defined in the Credit Agreement, at varying scales throughout the life of the Credit Agreement. The Facility grants the lenders preferred first priority liens and security interests in our capital stock, intercompany debt and all of our present and future property and assets, including each guarantor.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our Unaudited Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our estimates including those related to bad debts, inventories, valuation of goodwill, intangibles, other long-term assets, stock-based compensation, income taxes, and legal proceedings. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities not readily apparent from other sources. Actual results may differ from these estimates. Our critical accounting policies and estimates are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and there have been no material changes during the nine months ended September 30, 2016.

Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any off-balance sheet arrangements.

Contractual Obligations and Commitments

As of September 30, 2016, there were no material changes, outside of the ordinary course of business, in our outstanding contractual obligations from those disclosed within “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2016, there has been no material change in our assessment of our sensitivity to market risk since our presentation set forth in Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time lines specified in the SEC's rules and forms, and that such information 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. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in SEC Rules 13a - 15(e) and 15d - 15(e)) as of September 30, 2016. Based on such evaluation, our management has concluded that as of September 30, 2016, the Company's disclosure controls and procedures are effective.

#### Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of any potential changes in our internal control over financial reporting during the fiscal quarter covered by this Quarterly Report.

There has been no change to our internal control over financial reporting during our most recent fiscal quarter that our certifying officers concluded materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a description of our material pending legal proceedings, refer to Note 11 “Contingencies” of the Notes to Unaudited Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report, which is incorporated herein by reference.

Item 1A. Risk Factors

There were no material changes to the risk factors previously disclosed and included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. An investment in our common stock involves a high degree of risk. You should consider carefully the risks and uncertainties described under Item 1A of Part I of our Annual Report on Form 10-K, together with all other information contained or incorporated by reference in this report before you decide to invest in our common stock. If any of the Risk Factors were to actually occur, our business, financial condition, results of operations and our future growth prospects could be materially and adversely affected. Under the circumstances, the trading price of our common stock could decline, and you may lose all or part of your investment.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.



Table of Contents

Item 6. Exhibits

Exhibit

Number Description

- 3.1 Restated Certificate of Incorporation (incorporated by reference to our Quarterly Report on Form 10-Q filed with the SEC on August 13, 2004)
- 3.2 Certificate of Amendment to the Restated Certificate of Incorporation (incorporated by reference to our Current Report on Form 8-K filed with the SEC on September 28, 2011)
- 3.3 Restated Bylaws (incorporated by reference to our Current Report on Form 8-K filed with the SEC on January 6, 2012)
- 3.4 Amendment No. 1 to the Restated Bylaws (incorporated by reference to our Current Report on Form 8-K filed with the SEC on May 19, 2014)
- 3.5 Amendment No. 2 to the Restated Bylaws (incorporated by reference to our Current Report on Form 8-K filed with the SEC on August 1, 2016)
- 10.1† Settlement and Patent License Agreement dated July 13, 2016 between the Company and Medtronic plc together with its wholly owned subsidiaries Medtronic Sofamor Danek USA, Inc., Warsaw Orthopedic, Inc., Medtronic Puerto Rico Operations Co., and Medtronic Sofamor Danek Deggendorf GmbH
- 10.2# Letter Agreement dated September 11, 2016 between the Company and Patrick S. Miles
- 10.3# Notice of Grant of Share Purchase Matching Performance Restricted Stock Units and Award Agreement granted to Patrick S. Miles on September 11, 2016
- 31.1\* Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350
- 31.2\* Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350
- 32.1\* Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

† We have requested confidential treatment of certain portions of this agreement, which have been omitted and filed separately with the SEC pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

# Indicates management contract or compensatory plan.

\* These certifications are being furnished solely to accompany this annual report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of NuVasive, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.



Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NUVASIVE, INC.

Date: October 26, 2016 By: /s/ Gregory T. Lucier  
Gregory T. Lucier

Chairman and Chief Executive Officer

(Principal Executive Officer)

Date: October 26, 2016 By: /s/ Quentin S. Blackford  
Quentin S. Blackford

Executive Vice President and Chief Financial Officer, Head of Strategy and Corporate  
Integrity

(Principal Financial Officer)

Table of Contents

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\* These certifications are being furnished solely to accompany this annual report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of NuVasive, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.