NUVASIVE INC
Form 10-Q
November 04, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2011

OR

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

Commission file number 000-50744

NUVASIVE, INC.

(Exact name of registrant as specified in its charter)

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

7475 Lusk Boulevard

San Diego, CA 92121

(Address of principal executive offices, including zip code)

(858) 909-1800

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ 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. (Check one):

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

As of October 28, 2011, there were 42,244,073 shares of the registrant s common stock outstanding.

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NUVASIVE, INC.

QUARTERLY REPORT ON FORM 10-Q

September 30, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NUVASIVE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 220,943	$ 92,597
Short-term marketable securities	151,363	86,458
Accounts receivable, net	78,637	76,632
Inventory	122,588	107,577
Deferred tax assets	4,425	4,425
Prepaid expenses and other current assets	5,100	4,082
Total current assets	583,056	371,771
Property and equipment, net	118,125	102,165
Long-term marketable securities	46,593	50,635
Intangible assets, net	100,044	107,121
Goodwill	103,070	103,070
Deferred tax assets, non-current	76,260	52,033
Restricted cash and investments	68,463	5,529
Other assets	19,187	9,705
Total assets	$ 1,114,798	$ 802,029
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 52,191	$ 58,995
Accrued payroll and related expenses	17,872	17,266
Litigation liability	101,200	
Acquisition-related liabilities	33,628	32,715
Total current liabilities	204,891	108,976
Senior Convertible Notes	427,974	230,000
Long-term acquisition-related liabilities		326
Deferred tax liabilities	3,685	3,685
Other long-term liabilities	13,088	12,810
Commitments and contingencies		
Noncontrolling interests	11,015	11,877
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized, none outstanding		
Common stock, $0.001 par value; 120,000 and 70,000 shares authorized at September 30, 2011 and December 31, 2010, respectively; 39,904 and 39,528 issued and outstanding at September 30, 2011 and December 31, 2010, respectively	40	40
Additional paid-in capital	625,387	545,114

Accumulated other comprehensive income (loss)	(54)	616
Accumulated deficit	(171,228)	(111,415)
Total stockholders equity	454,145	434,355
Total liabilities and stockholders equity	$ 1,114,798	$ 802,029

See accompanying notes to unaudited condensed consolidated financial statements.

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NUVASIVE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Revenue	$ 132,880	$ 120,262	$ 390,312	$ 348,933
Cost of goods sold (excluding amortization of purchased technology)	26,015	21,580	75,049	62,037
Gross profit	106,865	98,682	315,263	286,896
Operating expenses:				
Sales, marketing and administrative	85,482	77,717	254,025	230,104
Research and development	10,092	10,085	31,119	31,989
Amortization of intangible assets	1,504	1,342	4,241	4,047
Litigation award	101,200		101,200	
Total operating expenses	198,278	89,144	390,585	266,140
Interest and other expense, net:				
Interest income	257	200	591	567
Interest expense	(7,276)	(1,668)	(10,962)	(5,005)
Other income (expense), net	1,726	(6)	2,303	81
Total interest and other expense, net	(5,293)	(1,474)	(8,068)	(4,357)
(Loss) income before income tax expense	(96,706)	8,064	(83,390)	16,399
Income tax (benefit) expense	(29,031)	(40)	(22,715)	1,399
Consolidated net (loss) income	$ (67,675)	$ 8,104	$ (60,675)	$ 15,000
Net loss attributable to noncontrolling interests	$ (123)	$ (438)	$ (862)	$ (1,353)
Net (loss) income attributable to NuVasive, Inc.	$ (67,552)	$ 8,542	$ (59,813)	$ 16,353
Net (loss) income per share attributable to NuVasive, Inc.:				
Basic	$ (1.69)	$ 0.22	$ (1.50)	$ 0.42
Diluted	$ (1.69)	$ 0.21	$ (1.50)	$ 0.40
Weighted average shares outstanding:				
Basic	39,892	39,394	39,766	39,180
Diluted	39,892	40,396	39,766	40,389

See accompanying notes to unaudited condensed consolidated financial statements.

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NUVASIVE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2011	**2010**
Operating activities:		
Consolidated net (loss) income	$ (60,675)	$ 15,000
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	24,847	27,404
Stock-based compensation	23,789	21,304
Allowance for excess and obsolete inventory	4,642	1,682
Allowance for doubtful accounts and sales return reserves, net of write offs	1,261	(1,039)
Accretion of contingent consideration	587	570
Amortization of debt issuance costs	2,588	1,120
Amortization of debt discount	3,076	
Gain recognized on change in fair value of derivatives	(2,387)	
Deferred income tax expense	6,238	
Other non-cash adjustments	3,545	2,924
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(3,152)	(11,465)
Inventory	(19,933)	(10,043)
Prepaid expenses and other assets	(1,061)	(3,878)
Accounts payable and accrued liabilities	504	6,502
Litigation liability	101,200	
Accrued payroll and related expenses	584	(5,973)
Income taxes payable	(32,237)	(186)
Net cash provided by operating activities	53,416	43,922
Investing activities:		
Purchases of property and equipment	(39,435)	(36,622)
Purchases of marketable securities	(244,209)	(150,045)
Sales of marketable securities	124,205	142,313
Purchases of restricted investments	(4,535)	
Payment for specific rights in connection with supply agreement, net of refund received	(5,000)	
Other assets	(1,100)	(659)
Net cash used in investing activities	(170,074)	(45,013)
Financing activities:		
Proceeds from the sale of warrants	47,898	
Proceeds from the issuance of convertible debt, net of issuance costs	391,334	
Purchase of convertible note hedges	(80,097)	
Repurchase of 2013 Senior Convertible Notes	(118,702)	
Proceeds from the issuance of common stock	4,461	12,768
Other assets	(349)	(7,722)
Tax benefits related to stock-based compensation awards	638	1,118
Net cash provided by financing activities	245,183	6,164
Effect of exchange rate changes on cash	(179)	104

Increase in cash and cash equivalents	128,346	5,177
Cash and cash equivalents at beginning of period	92,597	65,413
Cash and cash equivalents at end of period	$ 220,943	$ 70,590

See accompanying notes to unaudited condensed consolidated financial statements.

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NuVasive, Inc.

Notes to Unaudited Condensed 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. The Company is focused on developing minimally disruptive surgical products and procedures for the spine. The Company began commercializing its products in 2001. Its currently-marketed product portfolio is focused on applications for spine fusion surgery. Its principal product offering includes a minimally disruptive surgical platform called Maximum Access Surgery, or MAS®, as well as a growing offering of biologics, cervical and motion preservation products. In the spine surgery market, the Company s currently-marketed products are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally disruptive fashion. The Company also focuses significant research and development efforts on expanding its MAS product platform, advancing the applications of its unique technology to additional procedures, and developing motion preservation products. 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 who purchase disposables and implants 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. Implants and disposables are shipped from the Company s inventories. The Company sells an immaterial quantity of MAS instrument sets, MaXcess and nerve monitoring systems to hospitals.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (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). In the opinion of management, the consolidated financial statements include all adjustments necessary, which are of a normal and recurring nature, for the fair presentation of the Company s financial position and of the results of operations and cash flows for the periods presented.

The accompanying unaudited condensed consolidated financial statements as of September 30, 2011 and December 31, 2010 and for the three and nine months ended September 30, 2011 and 2010 include the accounts of the Company and its wholly owned subsidiaries, as well as the accounts of a variable interest entity, Progentix Orthobiology, B.V. (Progentix), which is consolidated pursuant to existing guidance issued by the Financial Accounting Standards Board (FASB). All significant intercompany accounts and transactions have been eliminated in consolidation.

These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2010 included in NuVasive s Annual Report on Form 10-K filed with the SEC. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The balance sheet at December 31, 2010 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

Change in Accounting Estimate

During the first quarter of 2011, the Company completed a review of the estimated useful life of its surgical instrument sets. Based on historical useful life information, as well as forecasted product life cycles and demand expectations, the useful life of certain surgical instrument sets was extended from three to four years. In accordance with authoritative guidance, this was accounted for as a change in accounting estimate and was made on a prospective basis effective January 1, 2011. For the three and nine months ended September 30, 2011, depreciation expense, which is included in sales, marketing and administrative expenses, was lower by approximately $1.2 million and $5.0 million, respectively, than it would have been had the useful life of these assets not been extended. The effect of this change on basic and diluted earnings per share for the three and nine months ended September 30, 2011 was $0.02 and $0.09 per share, respectively.

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Reclassifications and Adjustments

Certain reclassifications have been made to the prior year condensed consolidated financial statements to conform to the current year presentation.

During the three months ended June 30, 2011, the Company identified an immaterial error in the consolidated financial statements for the year ended December 31, 2010 related to the accrual of payroll expenses. Based on a quantitative and qualitative analysis of the error as required by authoritative guidance, management concluded that the correction, which increased expenses by approximately $1.3 million in the nine months ended September 30, 2011, had no material impact on any of the Company s previously issued financial statements, would be immaterial to the expected full year results for 2011 and had no effect on the trend of financial results. Of the $1.3 million, approximately $1.0 million and $0.3 million was charged to sales, marketing and administrative expenses and research and development expenses, respectively.

2. Significant Accounting Policies

Derivative Financial Instruments

On June 28, 2011, the Company issued $402.5 million principal amount of 2.75% Senior Convertible Notes due 2017 (the 2017 Notes). Prior to September 28, 2011, the 2017 Notes were settleable only in cash. On September 28, 2011, stockholder approval was obtained to increase the number of the Company s authorized shares of common stock from 70 million to 120 million. Prior to obtaining stockholder approval, in accordance with authoritative guidance, the cash conversion feature of the 2017 Notes (the 2017 Notes Embedded Conversion Derivative) required bifurcation from the 2017 Notes and was accounted for as a derivative liability.

In connection with the issuance of the 2017 Notes, the Company entered into convertible note hedge transactions (the 2017 Hedge) 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. Prior to obtaining the stockholder approval to increase the number of the Company s authorized shares of common stock discussed above, the 2017 Hedge was settleable only in cash. In accordance with authoritative guidance, the 2017 Hedge was accounted for as a derivative asset.

In accordance with authoritative guidance, upon obtaining stockholder approval to increase the number of authorized shares of the Company s common stock, as the Company can now settle the 2017 Notes in cash, stock, or a combination thereof, solely at the Company s election, the derivative liability and asset were marked to fair value and reclassified to stockholders equity.

During the three and nine months ended September 30, 2011, the Company recognized non-cash income of approximately $2.4 million related to the net change in the fair values of the derivative liability and asset. This $2.4 million consists of a $39.5 million gain related to the change in the fair value of the derivative liability and a loss of $37.1 million related to the change in fair value of the derivative asset. Gains and losses are included as a component of other income (expense), net.

Recently Adopted Accounting Standards

Fair Value Measurements Disclosures

Effective January 1, 2011, the Company adopted the FASB s updated guidance related to fair value measurements and disclosures, which requires a reporting entity to disclose separately information related to purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs, or Level 3, to be included in the rollforward of activity. The guidance is effective for interim or annual financial reporting periods beginning after December 15, 2010. The Company has updated its disclosures to comply with the updated guidance; however, adoption of the updated guidance did not have an impact on the Company s consolidated results of operations or financial position.

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3. Investment in Progentix Orthobiology, B.V.

In 2009, the Company completed the purchase of forty percent (40%) of the capital stock of 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 million in cash (the Initial Investment). Concurrent with the Initial Investment, NuVasive and Progentix also entered into a Senior Secured Facility Agreement, whereby Progentix may borrow up to $5.0 million from NuVasive to fund ongoing clinical and regulatory efforts (the Loan). At September 30, 2011, the Company had advanced Progentix the full $5.0 million in accordance with the Loan Agreement. The Loan accrues interest at a rate of six percent (6%) per year. Other than its obligations under the Loan Agreement, NuVasive is not obligated to provide additional funding, nor has any additional funding been provided, to Progentix.

Also concurrent with the Preferred Stock Purchase Agreement, NuVasive, Progentix and the Progentix Shareholders entered into an Option Purchase Agreement, as amended (the Option Agreement), whereby NuVasive may be obligated (the Put Option), upon the achievement of an annual sales run rate on Progentix products in excess of a specified amount between June 14, 2011 and June 13, 2013 (the Option Period), to purchase the remaining sixty percent (60%) of capital stock of Progentix from its shareholders (the Remaining Shares) for an amount up to $35.0 million, subject to certain reductions, payable in a combination of cash and NuVasive common stock, at NuVasive s sole discretion. In accordance with the Option Agreement, NuVasive has the right to purchase the Remaining Shares (the Call Option) during the Option Period for an amount up to $35.0 million, subject to certain reductions, payable in a combination of cash and NuVasive common stock, at NuVasive s sole discretion. Also in accordance with the Option Agreement, an option expired in June 2011 that could have required NuVasive to purchase the Remaining Shares and make additional milestone-related payments totaling up to $70.0 million, subject to certain adjustments. NuVasive and Progentix also entered into a Distribution Agreement, as amended, whereby Progentix appointed NuVasive as its exclusive distributor for certain Progentix products. The Distribution Agreement will be 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. Additionally, pursuant to this guidance, NuVasive is considered its primary beneficiary as NuVasive has both (1) the power to direct the economically significant activities of Progentix and (2) the obligation to absorb losses of, or the right to receive benefits from, Progentix. Accordingly, the financial position and results of operations of Progentix have been included in the Company s consolidated financial statements from the date of the Initial Investment. The liabilities recognized as a result of consolidating Progentix do not represent additional claims on the Company s general assets. The creditors of Progentix have claims only on the assets of Progentix, which are not material, and the assets of Progentix are not available to NuVasive.

Pursuant to authoritative guidance, the equity interests in Progentix not owned by the Company, which includes shares of both common and preferred stock, are reported as noncontrolling interests on the consolidated balance sheet of the Company. The preferred stock represents 18% of the noncontrolling equity interests and provides for a cumulative 8% dividend, if and when declared by Progentix s Board of Directors. As the rights and conversion features of the preferred stock are substantially the same as those of the common stock, the preferred stock is classified as noncontrolling interest and shares in the allocation of the losses incurred by Progentix. Losses incurred by Progentix are charged to the Company and to the noncontrolling interest holders based on their ownership percentage. The Remaining Shares and the Option Agreement that was entered into between NuVasive, Progentix and the Progentix Shareholders are not considered to be freestanding financial instruments as defined by authoritative guidance. Therefore the Remaining Shares and the Option Agreement are accounted for as a combined unit on the consolidated financial statements as a redeemable noncontrolling interest that was initially recorded at fair value and classified as mezzanine equity.

Total assets and liabilities of Progentix as of September 30, 2011 included in the accompanying condensed consolidated balance sheet are as follows *(in thousands):*

Total current assets	$ 834
Identifiable intangible assets, net	15,455
Goodwill	12,654
Other long-term assets	422
Accounts payable & accrued expenses	470
Other long-term liabilities	553
Deferred tax liabilities, net	3,685
Noncontrolling interests	11,015

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The following is a reconciliation of equity (net assets) attributable to the noncontrolling interests (*in thousands*):

Noncontrolling interests at December 31, 2010	$ 11,877
Net loss attributable to the noncontrolling interests	(862)
Noncontrolling interests at September 30, 2011	$ 11,015

4. Balance Sheet Reserves

The balances of the reserves for accounts receivable and inventory are as follows *(in thousands)*:

	September 30, 2011	December 31, 2010
Reserves for accounts receivable and sales returns	$ 3,533	$ 2,573
Reserves for excess and obsolete inventory	11,324	6,682

The Company s inventory consists primarily of purchased finished goods, which includes specialized implants and disposables, and is stated at the lower of cost or market determined by a weighted average cost method. The Company reviews the components of its inventory on a periodic basis for excess, obsolete or impaired inventory, and records a reserve for the identified items.

5. Marketable Securities and Fair Value Measurements

Marketable securities consist of certificates of deposit, corporate debt securities, commercial paper, U.S. government treasury securities and securities of government-sponsored entities. The Company classifies all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income in stockholders equity until realized. A decline in the market value of any marketable security below cost that is determined to be other-than-temporary will result in a revaluation of its carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. No such impairment charges were recorded for any period presented.

Realized gains and losses from the sale of marketable securities, if any, are determined on a specific identification basis. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other income or expense on the consolidated statements of operations. Realized gains and losses during the periods presented were immaterial. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the straight-line method and are included in interest income on the consolidated statements of operations. Interest and dividends on securities classified as available-for-sale are included in interest income on the consolidated statements of operations.

The composition of marketable securities is as follows (*in thousands, except years*):

	Contractual Maturity (in Years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011:					
Classified as current assets					
Certificates of deposit	Less than 1	$ 777	$ 1	$	$ 778
Corporate notes	Less than 1	21,206	9	(1)	21,214
Commercial paper	Less than 1	9,997			9,997
U.S. government treasury securities	Less than 1	34,760	5	(1)	34,764
Securities of government-sponsored entities	Less than 1	84,618	4	(12)	84,610

Short-term marketable securities		151,358	19	(14)	151,363
Classified as non-current assets					
Corporate notes	1 to 2	5,075	3		5,078
Securities of government-sponsored entities	1 to 2	41,506	17	(8)	41,515
Long-term marketable securities		46,581	20	(8)	46,593
Classified as restricted investments					
U.S. government treasury securities	Less than 1 to 2	12,030	11		12,041
Securities of government-sponsored entities	Less than 1 to 2	50,716	22	(13)	50,725
Restricted investments		62,746	33	(13)	62,766
Total marketable securities at September 30, 2011		$ 260,685	$ 72	$ (35)	$ 260,722

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	Contractual Maturity (in Years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2010:					
Classified as current assets					
Certificates of deposit	Less than 1	$ 938	$ 1	$ (1)	$ 938
Corporate notes	Less than 1	12,076	3		12,079
U.S. government treasury securities	Less than 1	16,550	12	(1)	16,561
Securities of government-sponsored entities	Less than 1	56,870	24	(14)	56,880
Short-term marketable securities		86,434	40	(16)	86,458
Classified as non-current assets					
Certificates of deposit	1 to 2	456			456
Corporate notes	1 to 2	3,123		(9)	3,114
U.S. government treasury securities	1 to 2	4,023			4,023
Securities of government-sponsored entities	1 to 2	43,056	6	(20)	43,042
Long-term marketable securities		50,658	6	(29)	50,635
Total marketable securities at December 31, 2010		$ 137,092	$ 46	$ (45)	$ 137,093

As of September 30, 2011, the Company had no significant investment positions that were in an unrealized loss position. The Company reviews its investments to identify and evaluate investments that have an indication of possible other-than-temporary impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. The Company maintains an investment portfolio of various holdings, types and maturities. The Company does not have derivative financial investments. The Company places its cash investments in instruments that meet high credit quality standards, as specified in its investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument.

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. The Company did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the nine months ended September 30, 2011. The Company had one transfer from Level 3 of the fair value measurement hierarchy, as the liability became fixed during the nine months ended September 30, 2011.

The fair values of the Company s assets and liabilities at September 30, 2011, which are measured at fair value on a recurring basis, were determined using the following inputs (*in thousands*):

	Total	Quoted Price in Active Market (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable Securities and Restricted Investments:				

Certificates of deposit	$ 778	$ 778	$	$
Corporate notes	26,292	26,292		
Commercial paper	9,997	9,997		
U.S. government treasury securities	46,805	46,805		
Securities of government-sponsored entities	176,850	176,850		
Total marketable securities and restricted investments	$ 260,722	$ 260,722	$	$
Contingent Consideration:				
Acquisition-related liabilities	$ (31,828)	$	$	$ (31,828)

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The fair and carrying value of the Company s Senior Convertible Notes is discussed in Note 7.

Contingent Consideration Liability

In connection with the acquisition of Cervitech®, Inc. (Cervitech) in May 2009, the Company is required to pay an additional amount not to exceed $33.0 million in the event that the PCM® cervical total disc replacement device receives U.S. Food and Drug Administration approval. The fair value of the contingent consideration is determined using a probability-weighted discounted cash flow model, the significant inputs which are not observable in the market. The key assumptions in applying this approach are the interest rate, the timing of expected approval and the probability assigned to the milestone being achieved. Based on the expected timing of the milestone being achieved, the estimated fair value of the contingent consideration decreased to $31.3 million at September 30, 2011. Changes in fair value are recorded in the statement of operations as sales, marketing and administrative expenses.

In connection with an immaterial acquisition in 2010, the Company is required to pay an additional amount not to exceed $3.0 million in the event three specified milestones are met. The fair value of the contingent consideration is determined using a probability-weighted discounted cash flow model, the significant inputs of which are not observable in the market. The key assumptions in applying this approach are the interest rate and the probabilities assigned to the milestones being achieved. During the three and nine months ended September 30, 2011, approximately $1.8 million of the total milestone payment became fixed and is no longer considered contingent consideration. Based on the probabilities assigned to the milestone being achieved, the estimated fair value of the remaining contingent consideration totaled approximately $0.5 million at September 30, 2011. Changes in fair value are recorded in the statement of operations as sales, marketing and administrative expenses.

Derivative Financial Instruments

Prior to their reclassification to stockholders equity on September 28, 2011, the 2017 Hedge and the 2017 Notes Embedded Conversion Derivative were classified as Level 3 because these assets and liabilities were not actively traded and were valued using significant unobservable inputs. Significant inputs to these models were the Company s stock price, risk free interest rate, credit rating, bond yield, and expected volatility of the Company s stock price.

The following table sets forth the changes in the estimated fair value for the Company s assets and liabilities measured using significant unobservable inputs (Level 3) (*in thousands*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Assets:				
Fair value measurement at beginning of period	$ 80,098	$	$	$
Derivative asset purchased in connection with 2017 Notes			80,098	
Change in fair value measurement included in operating expenses and other income (expense)	(37,124)		(37,124)	
Derivative asset reclassified to stockholders equity	(42,974)		(42,974)	
Fair value measurement at end of period	$	$	$	$
Liabilities:				
Fair value measurement at beginning of period	$ 122,855	$ 30,876	$ 33,041	$ 30,694
Derivative liability recorded in connection with 2017 Notes			88,900	
Change in fair value measurement included in operating expenses and other income (expense)	(39,837)	388	(38,923)	570
Derivative liability reclassified to stockholders equity	(49,390)		(49,390)	
Contingent consideration settled	(1,800)		(1,800)	
Fair value measurement at end of period	$ 31,828	$ 31,264	$ 31,828	$ 31,264

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6. Goodwill and Intangible Assets

Goodwill and intangible assets as of September 30, 2011 consisted of the following *(in thousands, except years)*:

	Weighted-Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net
Intangible Assets Subject to Amortization:				
Purchased technology:				
Developed technology	14	$ 37,535	$ (9,941)	$ 27,594
Manufacturing know-how and trade secrets	12	21,121	(5,519)	15,602
Trade name and trademarks	14	6,200	(1,294)	4,906
Customer relationships	13	10,035	(3,533)	6,502
	14	$ 74,891	$ (20,287)	$ 54,604
Intangible Assets Not Subject to Amortization:				
In-process research and development				45,440
Goodwill				103,070
Total intangible assets, net				$ 203,114

Goodwill and intangible assets as of December 31, 2010 consisted of the following *(in thousands, except years)*:

	Weighted-Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net
Intangible Assets Subject to Amortization:				
Purchased technology:				
Developed technology	14	$ 39,975	$ (7,946)	$ 32,029
Manufacturing know-how and trade secrets	12	21,104	(4,207)	16,897
Trade name and trademarks	14	6,100	(956)	5,144
Customer relationships	13	10,035	(2,984)	7,051
	14	$ 77,214	$ (16,093)	$ 61,121
Intangible Assets Not Subject to Amortization:				
In-process research and development				46,000
Goodwill				103,070
Total intangible assets, net				$ 210,191

Total expense related to the amortization of intangible assets was $1.5 million and $1.3 million for the three months ended September 30, 2011 and 2010, respectively, and $4.2 million and $4.0 million for the nine months ended September 30, 2011 and 2010, respectively. In-process research and development will be amortized beginning on the regulatory approval date of the respective acquired products and will be amortized over the estimated useful life determined at that time.

Total future amortization expense related to intangible assets subject to amortization at September 30, 2011 is set forth in the table below *(in thousands)*:

Remaining 2011	$ 1,460
2012	5,836
2013	5,818
2014	5,781
2015	5,450
2016	5,256
Thereafter through 2027	25,003
Total future amortization expense	$ 54,604

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7. Senior Convertible Notes

The carrying values of the Company s Senior Convertible Notes are as follows (*in thousands*):

	September 30, 2011	December 31, 2010
2.75% Senior Convertible Notes due 2017:		
Principal amount	$ 402,500	$
Unamortized debt discount	(85,824)	
	316,676	
2.25% Senior Convertible Notes due 2013	111,298	230,000
Total Senior Convertible Notes	$ 427,974	$ 230,000

2.75% Senior Convertible Notes due 2017

In June 2011, the Company issued $402.5 million principal amount of 2.75% Senior Convertible Notes due 2017 (the 2017 Notes), which includes the issuance of $52.5 million principal amount for the exercise of the initial purchasers option to purchase additional notes. The net proceeds from the offering, after deducting initial purchasers discounts and costs directly related to the offering, were approximately $359.0 million. The 2017 Notes have a stated interest rate of 2.75% and mature on July 1, 2017. Prior to September 28, 2011, the date on which stockholder approval to increase the number of the Company s authorized shares of common stock from 70 million to 120 million was obtained, the 2017 Notes were settleable only in cash. Subsequent to the receipt of this approval, the 2017 Notes may be settled in cash, stock, or a combination thereof, solely at the Company s election. The initial conversion rate of the 2017 Notes is 23.7344 shares per $1,000 principal amount, subject to adjustment (which represents an initial conversion price of approximately $42.13 per share).

Interest on the 2017 Notes began accruing in June 2011 and is payable semi-annually each January 1st and July 1st, beginning January 1, 2012. The fair value, based on quoted market prices, of the outstanding 2017 Notes at September 30, 2011 is approximately $338.1 million.

Prior to January 1, 2017, holders may convert their 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 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 the 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.

In accordance with authoritative guidance, the cash conversion feature of the 2017 Notes (the 2017 Notes Embedded Conversion Derivative) required bifurcation from the 2017 Notes and was initially accounted for as a derivative liability. The fair value of the 2017 Notes Embedded Conversion Derivative at the time of issuance of the 2017 Notes was $88.9 million, and was recorded as the original debt discount for purposes of accounting for the debt component of the 2017 Notes. On September 28, 2011, upon obtaining stockholder approval of the additional authorized shares of the Company s common stock, in accordance with authoritative literature, the derivative liability was marked to fair value and reclassified to stockholders equity. The original debt discount will be recognized as interest expense using the effective interest method over the term of the 2017 Notes.

In connection with the offering of the 2017 Notes, the Company entered into convertible note hedge transactions (the 2017 Hedge) with the initial purchasers and/or their affiliates (the 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. Prior to obtaining the stockholder approval to increase the number of the Company s authorized common shares discussed above, the 2017 Hedge was settleable only in cash and was accounted for as a derivative asset. The cost of the 2017 Hedge was $80.1 million. On September 28, 2011, upon obtaining stockholder approval of the additional authorized shares of the Company s common stock, in accordance with authoritative literature, the derivative asset was marked to fair value and

reclassified to stockholders equity. 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 the Company s common stock exceeds the strike price of the 2017 Hedge.

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In addition, the Company sold warrants to the Counterparties to acquire up to 477,654 shares of the Company s Series A Participating Preferred Stock (the 2017 Warrants), 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 the Company s common stock. The 2017 Warrants expire on various dates from September 2017 through January 2018 and may be settled in cash or net shares. The Company received $47.9 million in cash proceeds from the sale of the 2017 Warrants, which has been recorded as an increase 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 (the quarter or year-to-date period) exceeds the strike price of the 2017 Warrants.

2.25% Senior Convertible Notes due 2013

In March 2008, the Company issued $230.0 million principal amount of 2.25% unsecured Senior Convertible Notes (the 2013 Notes), which includes the subsequent exercise of the initial purchasers option to purchase an additional $30.0 million aggregate principal amount of the 2013 Notes. The net proceeds from the offering, after deducting the initial purchasers discounts and costs directly related to the offering, were approximately $208.4 million.

During the three and nine months ended September 30, 2011, the Company repurchased, in privately negotiated transactions, approximately $118.7 million in principal of its 2013 Notes. The aggregate purchase price totaled approximately $119.0 million (representing a price of approximately 99.4% of the principal face value of the 2013 Notes, plus accrued interest). The repurchases were made using a portion of the net proceeds from the issuance of the 2017 Notes. Including the write off of a portion of the deferred financing costs related to the 2013 Notes, the Company recorded a loss on the extinguishment of debt of approximately $0.7 million. At September 30, 2011, approximately $111.3 million of the 2013 Notes original aggregate principal amount of $230.0 million remains outstanding.

The Company pays 2.25% interest per annum on the principal amount of the 2013 Notes, payable semi-annually in arrears in cash on March 15 and September 15 of each year. Any of the 2013 Notes not converted prior to March 15, 2013, the Maturity Date, will be paid in cash. The fair value, based on quoted market prices, of the outstanding 2013 Notes at September 30, 2011 is approximately $108.0 million.

The 2013 Notes are convertible into shares of the Company s common stock, based on an initial conversion rate, subject to adjustment, of 22.3515 shares per $1,000 principal amount of the 2013 Notes (which represents an initial conversion price of approximately $44.74 per share). Holders may convert their 2013 Notes at their option on any day up to and including the second scheduled trading day immediately preceding the Maturity Date. If a fundamental change to the Company s business occurs, as defined in the 2013 Notes, holders of the 2013 Notes have the right to require that the Company repurchase the 2013 Notes, or a portion thereof, at the principal amount plus accrued and unpaid interest.

In connection with the offering of the 2013 Notes, the Company entered into convertible note hedge transactions (the 2013 Hedge) with the initial purchasers and/or their affiliates (the 2013 Counterparties) entitling the Company to purchase up to 5.1 million shares of the Company s common stock at an initial stock price of $44.74 per share, each of which is subject to adjustment. In addition, the Company sold to the 2013 Counterparties warrants to acquire up to 5.1 million shares of the Company s common stock (the 2013 Warrants), at an initial strike price of $49.13 per share, subject to adjustment. The cost of the 2013 Hedge that was not covered by the proceeds from the sale of the 2013 Warrants was approximately $14.0 million and was recorded as a reduction of additional paid-in capital as of December 31, 2008. The impact of the 2013 Hedge is to raise the effective conversion price of the 2013 Notes to approximately $49.13 per share (or approximately 20.3542 shares per $1,000 principal amount of the 2013 Notes). The 2013 Hedge is expected to reduce the potential equity dilution upon conversion of the 2013 Notes if the daily volume-weighted average price per share of the Company s common stock exceeds the strike price of the 2013 Hedge. The 2013 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 (the quarter or year to date period) exceeds the strike price of the 2013 Warrants.

8. Series A Preferred Securities

On June 28, 2011, in connection with the issuance of the 2017 Warrants, the Company amended its Restated Certificate of Incorporation to designate 477,654 shares of the Company s authorized preferred stock, par value $0.001 per share, as Series A Participating Preferred Stock (the Series A Preferred Stock). The Series A Preferred Stock will automatically convert into shares of the Company s common stock.

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The holders of Series A Preferred Stock (collectively, the Preferred Holders) are entitled to receive dividends when and if declared by the Board of Directors. The preferred dividends are payable in preference and in priority to any dividends on the Company s common stock.

Shares of Series A Preferred Stock are convertible into 20 shares of common stock, subject to certain antidilution adjustments. Preferred Holders vote on an equivalent basis with common stockholders on an as-converted basis.

The Preferred Holders are entitled to receive liquidation preferences at the rate of $648.20 per share. Liquidation payments to the Preferred Holders have priority and are made in preference to any payments to the holders of common stock.

9. Net (Loss) Income Per Share

The Company computes basic net (loss) income per share using the weighted-average number of common shares outstanding during the period. Diluted net (loss) income per share assumes the conversion, exercise or issuance of all potential common stock equivalents, unless the effect of inclusion would be anti-dilutive. For purposes of this calculation, common stock equivalents include the Company s stock options, unvested restricted stock units, warrants and the shares to be issued upon the conversion of the 2013 Notes and the 2017 Notes. No shares related to the assumed conversion of the 2013 Notes or the 2017 Notes were included in the diluted net (loss) income per share calculation for the three and nine months ended September 30, 2011 and 2010 because the inclusion of such shares would have had an anti-dilutive effect. The shares to be issued upon exercise of all outstanding warrants were excluded from the diluted net (loss) income calculation for the three and nine months ended September 30, 2011 and 2010 because the inclusion of such shares would have had an anti-dilutive effect.

The following table sets forth the computation of basic and diluted (loss) earnings per share *(in thousands, except per share data)*:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Numerator:				
Net (loss) income attributable to NuVasive, Inc.	$ (67,552)	$ 8,542	$ (59,813)	$ 16,353
Denominator for basic and diluted net (loss) income per share:				
Weighted average common shares outstanding for basic	39,892	39,394	39,766	39,180
Dilutive potential common stock outstanding:				
Stock options		807		1,046
Restricted stock units		195		163
Weighted average common shares outstanding for diluted	39,892	40,396	39,766	40,389
Basic net (loss) income per share attributable to NuVasive, Inc.	$ (1.69)	$ 0.22	$ (1.50)	$ 0.42
Diluted net (loss) income per share attributable to NuVasive, Inc.	$ (1.69)	$ 0.21	$ (1.50)	$ 0.40

The following outstanding common stock equivalents were not included in the calculation of diluted net (loss) income per share because their effects were anti-dilutive *(in thousands)*:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Weighted stock options and RSUs	6,223	4,043	6,076	2,874
Warrants	5,141	5,141	5,141	5,141
2013 Notes	3,619	5,141	4,628	5,141
2017 Notes	9,553		3,289	
Total	24,536	14,325	19,134	13,156

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10. Comprehensive (Loss) Income

The components of comprehensive (loss) income are as follows (*in thousands*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Consolidated net (loss) income	$(67,675)	$8,104	$(60,675)	$15,000
Other comprehensive (loss) income:				
Unrealized gain (loss) on investments	11	(10)	36	85
Translation adjustments	(1,763)	1,480	(707)	410
Total consolidated comprehensive (loss) income	(69,427)	9,574	(61,346)	15,495
Plus: Net loss attributable to noncontrolling interests	(123)	(438)	(862)	(1,353)
Comprehensive (loss) income attributable to NuVasive, Inc.	$(69,304)	$10,012	$(60,484)	$16,848

11. Stock-Based Compensation

The Company estimates the fair value of stock options and shares issued to employees under the Employee Stock Purchase Plan (ESPP Plan) using a Black-Scholes option-pricing model on the date of grant. The fair value of restricted stock units (RSUs) is based on the stock price on the date of grant. The fair value of equity instruments that are expected to vest are recognized and amortized on an accelerated basis over the requisite service period.

The weighted-average assumptions used to estimate the fair value of stock options granted and stock purchase rights under the ESPP Plan are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Stock Options				
Volatility	49%		49%	47%
Expected term (years)	5.0		5.3	4.5
Risk free interest rate	1.8%		2.1%	2.4%
Expected dividend yield	0.0%		0.0%	0.0%
ESPP				
Volatility	55%	55%	58%	53%
Expected term (years)	1.4	1.4	1.2	1.4
Risk free interest rate	0.3%	0.8%	0.2%	0.9%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%

The compensation costs included in the consolidated statement of operations for all stock-based compensation arrangements are as follows (*in thousands)*:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Sales, marketing and administrative expense	$7,497	$6,494	$21,956	$18,846
Research and development expense	621	827	1,833	2,458
Total stock-based compensation expense	$8,118	$7,321	$23,789	$21,304

The Company issued 8,000 and 104,000 shares of common stock upon exercise of stock options during the three and nine months ended September 30, 2011, respectively, and issued 524,000 shares of common stock upon exercise of stock options during the year ended December 31, 2010. The Company issued 28,000 and 148,000 shares of common stock upon the vesting of RSUs during the three and nine months ended September 30, 2011, respectively, and issued 73,000 shares of common stock upon the vesting of RSUs during the year ended

December 31, 2010.

12. Income Taxes

The Company recorded an income tax benefit of $29.0 million and $40,000 for the three months ended September 30, 2011 and 2010, respectively, and recorded an income tax benefit of $22.7 million and income tax expense of $1.4 million for the nine months ended September 30, 2011 and 2010, respectively. The effective income tax benefit rate for the nine months ended September 30, 2011 was 27%, which is based on an estimate of the Company s annual effective income tax rate. The Company updates its annual effective income tax rate each quarter and if the estimated effective income tax rate changes, a cumulative adjustment is made.

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As a result of the litigation award accrual totaling $101.2 million recorded in the three and nine months ended September 30, 2011, the Company evaluated the need for a valuation allowance of its deferred tax assets by reviewing all available positive and negative evidence. Based on this review, the Company concluded that it was more likely than not that the Company would be able to realize the benefit of its U.S. federal deferred tax assets and its deferred tax assets for all states except California in the future. This conclusion was primarily based on historical and projected operating performance, as well as the Company s expectation that operations will generate sufficient taxable income in future periods to realize the tax benefits associated with the federal deferred tax assets well within the statutory carryover periods. Accordingly, the Company did not establish a valuation allowance on its federal or non-California state deferred tax assets as of September 30, 2011.

Based on this same evidence and consideration of the state of California s past and current suspension of the use of net operating loss carryforwards, the state of California s statutory carryover periods and the Company s apportionment election beginning in 2011, the Company concluded that it is more likely than not that the Company will not be able to utilize its California deferred tax assets. Therefore, the Company established a full valuation allowance on its California deferred tax assets as of September 30, 2011. Accordingly, the income tax benefit reported for the three and nine months ended September 30, 2011, includes income tax expense totaling $4.8 million in connection with the establishment of this valuation allowance.

In addition, certain future tax deductions will no longer be realized as a result of the repurchase of $118.7 million of the 2013 Notes. Accordingly, the income tax benefit for the three and nine months ended September 30, 2011 includes a charge totaling $1.5 million representing the write off of deferred tax assets associated with these future deductions.

There was no material change to the Company s unrecognized tax benefits and interest accrued related to unrecognized tax benefits during the nine months ended September 30, 2011.

13. Business Segment and Product Information

The Company s business operates in one segment based upon the Company s organizational structure, the way in which the operations are managed and evaluated and the lack of availability of separate financial results. Substantially all of the Company s assets and sales are in the United States.

The Company s spine surgery product line offerings, which include thoracolumbar product offerings, cervical offerings, and a set of motion preservation products still under development, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally disruptive fashion. The Company s biologic product line offerings include allograft (donated human tissue), Osteocel® Plus , an allograft cellular matrix containing viable mesenchymal stem cells, or MSCs, to aid in spinal fusion, and FormaGraft®, a collagen synthetic product used to aid the fusion process. Revenue by product line offerings was as follows *(in thousands):*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Spine Surgery Products	$ 107,340	$ 97,477	$ 317,638	$ 284,169
Biologics	25,540	22,785	72,674	64,764
Total Revenue	$ 132,880	$ 120,262	$ 390,312	$ 348,933

14. Legal Proceedings

Medtronic Sofamor Danek USA, Inc. Litigation

In August 2008, Medtronic Sofamor Danek USA, Inc. and its related entities (Medtronic) filed suit against NuVasive in the United States District Court for the Southern District of California (Medtronic Litigation), alleging that certain of NuVasive s products 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 patents. NuVasive brought counterclaims against Medtronic alleging infringement of certain of NuVasive s patents. The case has been administratively broken into serial phases. The first phase of the case includes three Medtronic patents and one NuVasive patent. Trial on the first phase of the case began in August 2011 and on September 20, 2011, a jury from the U.S. District Court, Southern District of California delivered an unfavorable verdict against NuVasive with respect to three Medtronic patents and a favorable verdict in favor of NuVasive with respect to one NuVasive patent. Judgment was entered by the Court on September 29, 2011. The jury awarded monetary damages of approximately $101.2 million to Medtronic which includes lost profits and back royalties. As Medtronic has filed for a permanent injunction and an increase in damages, additional fees and costs, potential future royalties and injunctive relief may be awarded as part of a final judgment

which is expected in the coming months. While the Company intends to timely appeal the unfavorable verdict, in accordance with the authoritative guidance on the evaluation of loss contingencies, during the three and nine months ended September 30, 2011, the Company recorded an accrual for the $101.2 million verdict. In addition, the Company is currently planning to accrue ongoing royalties on future sales at the royalty rates stated in the jury verdict. The $101.2 million is recorded as a separate line item within operating expenses as the split between lost profit and royalty amounts are not known. The Company may be required to secure the amount of the judgment during the appeals process.

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With respect to the favorable verdict delivered regarding the one NuVasive patent, 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 has not been recorded at September 30, 2011.

Trademark Infringement Litigation

In September 2009, Neurovision Medical Products, Inc. (NMP) filed suit against NuVasive 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. On November 23, 2009, the Company denied the allegations in NMP s complaint. After trial of the matter, on October 25, 2010 an unfavorable jury verdict was delivered against the Company relating to its use of the NeuroVision trade name. The verdict awarded damages to NMP of $60.0 million. On January 3, 2011, the Court ordered a judgment be entered in the case in the amount of $60.0 million, and granted a permanent injunction prohibiting the Company s use of the NeuroVision name for marketing purposes. The Company sought emergency relief, and on February 3, 2011, the Ninth Circuit Court of Appeals stayed enforcement of the injunction. The Company has appealed the judgment and permanent injunction. During pendency of the appeal, the Company has been required to escrow funds to secure the amount of the judgment, plus interest, attorneys fees and costs. On June 16, 2011, the Company entered into an escrow arrangement and transferred $62.5 million of cash and investments into a restricted escrow account. These funds are included in restricted cash and investments on the Company s September 30, 2011 condensed consolidated balance sheet. Any payment of damages will be delayed while the appeals process runs its course, which could take up to two years. The Company continues to believe that the verdict is not supported by the facts or by applicable law. The Company, based on its own assessment as well as that of outside counsel, believes that the trial court committed a number of prejudicial legal errors and that these errors were significant, making the possibility of reversal of the judgment on appeal and/or a new trial probable. At September 30, 2011, in accordance with the authoritative guidance on the evaluation of contingencies, the Company has not recorded an accrual related to this litigation. The Company may be required to record an expense related to this damage award in the future.

Contingencies

The Company is party to certain claims and legal actions arising in the normal course of business. The Company does not expect any such claims and legal actions to have a material adverse effect on its business, results of operations or financial condition.

15. Subsequent Event

Impulse Monitoring, Inc. Acquisition

On October 7, 2011 (the Closing Date), the Company completed the purchase of all of the outstanding shares of Impulse Monitoring, Inc., (IMI), a Delaware corporation, pursuant to an Agreement and Plan of Merger dated September 28, 2011 (the Merger Agreement) for an initial payment of approximately $80.0 million consisting of cash totaling approximately $40.5 million and the issuance of 2,336,200 shares of NuVasive common stock to certain stockholders of IMI. IMI, a company headquartered in Maryland, is a leading provider of outsourced intraoperative monitoring (IOM) services to hospitals and became a wholly owned subsidiary of the Company upon completion of the acquisition. The acquisition allows the Company to increase its IOM service business, which is a long-standing service providing solutions for the detection of neurological compromise and identification of functional neural structures during surgeries that involve spine, cardio, ENT, brain and general orthopedic. The acquisition complements the Company s existing nerve monitoring systems, which are designed for discreet and directional nerve avoidance and detection, making lateral access to the spine during the XLIF® procedure more safe and reproducible.

Purchase Price

The acquisition of IMI will be recorded using the acquisition method of accounting in accordance with the authoritative guidance for business combinations.

The estimated initial purchase price is estimated as follows (*in thousands)*:

Cash paid to sellers	$ 40,500
Market value of NuVasive common stock issued on Closing Date	39,500

Total estimated initial purchase price	$ 80,000

The preliminary allocation of the estimated initial purchase price is based on management s preliminary valuation of the fair value of tangible assets, intangible assets and acquired and liabilities assumed as of the Closing Date and such estimates are subject to revision. As of the date of this Form 10-Q, the Company has not completed the detailed valuations necessary to finalize the estimate of the fair

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value of the assets acquired and the liabilities assumed from IMI and the related allocations of the estimated initial purchase price. Thus, the estimated initial purchase price allocation below is preliminary, and is subject to further adjustment. The final purchase price allocation is pending the completion of the Company s internal review of the valuation work, which is expected to be completed during the fourth quarter of 2011. The provisional items pending finalization are the valuation of the acquired intangible assets, goodwill, property and equipment, total other current assets, liabilities assumed, and income tax related matters.

The acquisition of IMI occurred subsequent to September 30, 2011. Accordingly, the assets acquired and liabilities assumed from IMI, the consideration paid to acquire IMI, and the results of IMI s operations are not reflected in the Company s condensed consolidated financial statements as of the three and nine months ended September 30, 2011.

The following preliminary allocation of the estimated initial purchase price is subject to change, and the final amounts may differ. The following table summarizes the allocation of the estimated initial purchase price (*in thousands*):

	Estimated Fair Value	Estimated Useful Life
Cash	$ 5,100	
Total other current assets	6,900	
Property, plant and equipment	1,100	
Developed technology	700	5 years
Non-compete agreement	400	2 years
Trade name	500	3 years
Customer relationships	24,700	10 years
Goodwill	58,400	
Current liabilities	(9,100)	
Deferred income tax liabilities	(8,700)	
Total estimated initial purchase price allocation	$ 80,000	

Goodwill totaling $58.4 million represents the excess of the estimated initial purchase price over the fair value of tangible and identifiable intangible assets acquired and is due primarily to customers and synergies expected from combining the assembled workforce with the Company s existing IOM workforce. This acquisition was nontaxable and, as a result, there is no tax basis in goodwill. Accordingly, none of the goodwill associated with the IMI acquisition is deductible for tax purposes.

Results of Operations

The Company has prepared the following unaudited pro forma financial statement information to compare results of the periods presented assuming the IMI acquisition had occurred as of January 1, 2010. These unaudited pro forma results have been prepared for comparative purposes only and do not purport to be an indicator of the results of operations that would have actually resulted had the acquisition occurred at the beginning of each of the periods presented, or of future results of operations. Assuming the IMI acquisition occurred as of January 1, 2010, the pro forma unaudited results of operations would have been as follows for the three and nine months ended September 30, 2011 and 2010 (using the preliminary allocation of the estimated purchase price above which is subject to change) (*in thousands, except per share data*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue	$ 143,293	$ 128,281	$ 419,714	$ 372,331
Net (loss) income attributable to NuVasive, Inc.	$ (66,426)	$ 8,656	$ (57,882)	$ 13,838
Net (loss) income per share basic	$ (1.57)	$ 0.21	$ (1.37)	$ 0.33
Net (loss) income per share diluted	$ (1.57)	$ 0.20	$ (1.37)	$ 0.32

The above pro forma unaudited results of operations do not include pro forma adjustments relating to costs of integration or post-integration cost reductions that may be incurred or realized by the Company in excess of actual amounts incurred or realized through September 30, 2011.

For the three and nine months ended September 30, 2011, the Company s condensed consolidated results of operations include acquisition-related expenses of $0.5 million which are included in sales, marketing and administrative expenses.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements May Prove Inaccurate

You should read the following discussion of our financial condition and results of operations in conjunction with the unaudited condensed consolidated financial statements and the notes to those statements included in this report. This discussion may contain

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forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, such as those set forth under heading Risk Factors, and elsewhere in this report, and similar discussions in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the year ended December 31, 2010. We do not intend to update these forward looking statements to reflect future events or circumstances.

Overview

We are a medical device company focused on developing minimally disruptive surgical products and procedures for the spine. Our currently-marketed product portfolio is focused on applications for spine fusion surgery, including biologics, a combined market estimated to exceed $7.7 billion globally in 2011. Our principal product offering includes a minimally disruptive surgical platform called Maximum Access Surgery, or MAS®, as well as a growing offering of biologics, cervical and motion preservation products. Our spine surgery product line offerings, which include products for the thoracolumbar spine, the cervical spine, and a set of motion preservation product offerings still under development, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally disruptive fashion. Our biologic product line offerings include allograft (donated human tissue), Osteocel® Plus , an allograft cellular matrix containing viable mesenchymal stem cells, or MSCs, to aid in spinal fusion, and FormaGraft®, a collagen synthetic product used to aid the fusion process. We focus significant research and development efforts to expand our MAS product platform, advance the applications of our unique technology to additional procedures and develop motion preserving products such as our total disc replacement products. We dedicate significant resources to