

NUVASIVE INC
Form 10-Q
July 31, 2018

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 June 30, 2018

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Small reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 July 29, 2018 there were 51,422,448 shares of the registrant's common stock (par value \$0.001 per share) outstanding.

NuVasive, Inc.

Quarterly Report on Form 10-Q

June 30, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NUVASIVE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except par values and share amounts)

	June 30, 2018	December 31, 2017
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$70,078	\$72,803
Restricted cash and investments	—	3,901
Accounts receivable, net of allowances of \$16,782 and \$13,026, respectively	199,907	200,220
Inventory, net	259,819	247,138
Prepaid income taxes	18,187	17,209
Prepaid expenses and other current assets	23,588	18,792
Total current assets	571,579	560,063
Property and equipment, net	231,733	215,326
Intangible assets, net	276,318	280,774
Goodwill	560,751	536,926
Deferred tax assets	4,955	6,440
Restricted cash and investments	2,394	1,494
Other assets	24,607	39,117
Total assets	\$1,672,337	\$1,640,140
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$89,534	\$75,767
Contingent consideration liabilities	12,214	18,952
Accrued payroll and related expenses	51,128	55,618
Litigation liabilities	10,300	8,150
Short-term borrowings	37,000	—
Income tax liabilities	3,825	2,908
Total current liabilities	204,001	161,395
Long-term senior convertible notes	592,581	582,920
Deferred and income tax liabilities, non-current	9,525	18,870
Other long-term liabilities	85,067	77,539
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized, none outstanding	—	—
Common stock, \$0.001 par value; 120,000,000 shares authorized at June 30, 2018 and December 31, 2017, 56,511,851 and 56,164,060 issued and outstanding at June 30, 2018 and December 31, 2017, respectively	61	60
Additional paid-in capital	1,371,436	1,363,549

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Accumulated other comprehensive loss	(8,875)	(6,933)
(Accumulated deficit) retained earnings	(10,839)	4,762
Treasury stock at cost; 5,095,290 shares and 5,001,886 shares at June 30, 2018 and December 31, 2017, respectively	(570,620)	(565,867)
Total NuVasive, Inc. stockholders' equity	781,163	795,571
Non-controlling interest	—	3,845
Total equity	781,163	799,416
Total liabilities and equity	\$1,672,337	\$1,640,140

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue				
Product revenue	\$252,687	\$237,824	\$486,202	\$462,779
Service revenue	28,877	21,575	55,884	45,633
Total revenue	281,564	259,399	542,086	508,412
Cost of revenue (excluding below amortization of intangible assets)				
Cost of products sold	58,202	50,535	113,393	96,436
Cost of services	18,854	15,651	37,477	31,193
Total cost of revenue	77,056	66,186	150,870	127,629
Gross profit	204,508	193,213	391,216	380,783
Operating expenses:				
Sales, marketing and administrative	145,658	138,967	292,424	279,335
Research and development	14,856	12,572	29,347	24,986
Amortization of intangible assets	12,628	11,349	25,053	23,410
Litigation liability (gain) loss	(1,195)	—	27,800	—
Business transition costs	3,998	1,369	6,251	1,424
Total operating expenses	175,945	164,257	380,875	329,155
Interest and other expense, net:				
Interest income	116	139	250	276
Interest expense	(9,956)	(10,083)	(19,423)	(19,882)
Other expense, net	(2,379)	(501)	(12,082)	(243)
Total interest and other expense, net	(12,219)	(10,445)	(31,255)	(19,849)
Income (loss) before income taxes	16,344	18,511	(20,914)	31,779
Income tax (expense) benefit	(4,813)	(6,776)	5,313	(8,061)
Consolidated net income (loss)	\$11,531	\$11,735	\$(15,601)	\$23,718
Add back net loss attributable to non-controlling interest	\$—	\$(432)	\$—	\$(875)
Net income (loss) attributable to NuVasive, Inc.	\$11,531	\$12,167	\$(15,601)	\$24,593
Net income (loss) per share attributable to NuVasive, Inc.:				
Basic	\$0.22	\$0.24	\$(0.30)	\$0.48
Diluted	\$0.22	\$0.21	\$(0.30)	\$0.42
Weighted average shares outstanding:				
Basic	51,356	51,082	51,292	50,825
Diluted	51,956	58,330	51,292	58,059

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)	Three Months		Six Months Ended	
	Ended June 30,	Ended June 30,	June 30,	June 30,
	2018	2017	2018	2017
Consolidated net income (loss)	\$ 11,531	\$ 11,735	\$ (15,601)	\$ 23,718
Other comprehensive (loss) income:				
Unrealized gain (loss) on marketable securities, net of tax	—	1	—	(1)
Translation adjustments, net of tax	(4,522)	642	(1,943)	2,501
Other comprehensive (loss) income	(4,522)	643	(1,943)	2,500
Total consolidated comprehensive income (loss)	7,009	12,378	(17,544)	26,218
Net loss attributable to non-controlling interest	—	(432)	—	(875)
Comprehensive income (loss) attributable to NuVasive, Inc.	\$ 7,009	\$ 12,810	\$ (17,544)	\$ 27,093

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30,	
(unaudited)	2018	2017
Operating activities:		
Consolidated net (loss) income	\$(15,601)	\$23,718
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	64,151	58,688
Impairment of strategic investment	9,004	—
Amortization of non-cash interest	9,920	10,882
Stock-based compensation	10,994	15,411
Reserves on current assets	9,444	64
Other non-cash adjustments	12,133	7,380
Deferred income taxes	(6,593)	(3,077)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	852	(15,823)
Inventory	(19,615)	(29,417)
Contingent consideration liabilities	(100)	(11,200)
Prepaid expenses and other current assets	(2,141)	(2,543)
Accounts payable and accrued liabilities	9,031	4,868
Accrued payroll and related expenses	(6,358)	(2,059)
Litigation liability	2,150	—
Income taxes	(53)	10,172
Net cash provided by operating activities	77,218	67,064
Investing activities:		
Acquisitions and investments	(52,081)	(14,417)
Purchases of intangible assets	(7,682)	(1,695)
Purchases of property and equipment	(53,388)	(68,690)
Net cash used in investing activities	(113,151)	(84,802)
Financing activities:		
Proceeds from the issuance of common stock	5,312	5,369
Purchase of treasury stock	(2,222)	(10,844)
Payment of contingent consideration	(8,900)	(18,800)
Proceeds from revolving line of credit	82,000	20,000
Repayments on revolving line of credit	(45,000)	—
Other financing activities	(146)	(2,205)
Net cash provided by (used in) financing activities	31,044	(6,480)
Effect of exchange rate changes on cash	(837)	1,449
Decrease in cash, cash equivalents, restricted cash and investments	(5,726)	(22,769)
Cash, cash equivalents, restricted cash and investments at beginning of period	78,198	161,048

Cash, cash equivalents, restricted cash and investments at end of period	\$72,472	\$138,279
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The following table provides a reconciliation of cash, cash equivalents, restricted cash and investments reported on our Unaudited Consolidated Statements of Cash Flows for the periods presented:

	Six Months Ended June 30,	
	2018	2017
Cash and cash equivalents	\$70,078	\$130,932
Restricted cash and investments, current	—	2,402
Restricted cash and investments, non-current	2,394	4,945
Total cash, cash equivalents, restricted cash and investments shown in the Unaudited Consolidated Statement of Cash Flows	\$72,472	\$138,279
See accompanying Notes to Unaudited Consolidated Financial Statements.		

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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. To assist with surgical procedures the Company offers a technology platform called 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 procedurally integrated solutions use innovative, technological advancements and the MAS platform to provide surgical efficiency, operative reliability, and procedural versatility. The Company offers a range of implants for spinal surgery, which include its branded CoRoent products and porous titanium and polyetheretherketone implants under its Advanced Materials Science portfolio, fixation devices such as customizable rods, plates and screws, bone allograft in patented saline packaging, allogeneic and synthetic biologics, and disposables used in IOM. The Company makes available MAS instrument sets, MaXcess and neuromonitoring systems to hospitals to facilitate surgeon access to the spine to perform restorative and fusion procedures using the Company’s implants and fixation devices. The Company sells MAS instrument sets, MaXcess and neuromonitoring systems to hospitals, however, such sales are immaterial to the Company’s results of operations.

The Company also 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, which allows for the minimally invasive treatment of early-onset and adolescent scoliosis. This technology is also the basis for the Company’s PRECICE limb lengthening system, which allows for the correction of long bone limb length discrepancy, as well as enhanced bone healing in patients that have experienced traumatic injury.

The Company intends to continue development on a wide variety of projects intended to broaden surgical applications for greater procedural integration of its MAS techniques and additional applications of the MAGEC technology. Such applications include tumor, trauma, and deformity, as well as increased fixation options, sagittal alignment products, imaging and navigation. 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, procedurally integrated solution for spine surgery. The

Company intends to continue to pursue business and technology acquisition targets and strategic partnerships.

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 interest at the acquisition date and classifies the amounts attributable to non-controlling interest 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.

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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 generally accepted accounting principles in the United States (“GAAP”). Operating results for the three and six months ended June 30, 2018 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, 2017 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 and notes thereto 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 revenue and cost of revenue to conform to the current year presentation, which now reflects revenue and costs allocated to the Company’s product and service offerings. These reclassifications had no impact on previously reported results of operations. Additionally, as required by Accounting Standards Update 2014-09 Revenue from Contracts with Customers (“ASU 2014-09”), on January 1, 2018 the Company adopted Accounting Standards Codification 606 Revenue from Contracts with Customers (“ASC 606”), electing full retrospective method of adoption.

Use of Estimates

To prepare financial statements in conformity with GAAP, management must 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 February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-02, Leases, which introduced ASC 842 – Leases, a new comprehensive lease accounting model that supersedes the current lease guidance under ASC 840 – Leases. The new accounting standard requires lessees to recognize right-of-use assets and corresponding lease liabilities for all leases with lease terms of greater than twelve 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 impact the adoption will have on its Consolidated Financial Statements and expects significant changes relating to the recognition of right-of-use assets and liabilities associated with its operating leases.

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 believes the adoption will modify the way the Company analyzes financial instruments, but it does not anticipate a material impact on results of operations. The Company is in the process of determining the effects the adoption will have on its Consolidated

Financial Statements as well as whether to early adopt the new guidance.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, Intangibles – Goodwill and Other, which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit’s carrying amount over its fair value. The standard has tiered effective dates, starting in 2020 for calendar-year public business entities that meet the definition of an SEC filer. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company is in the process of determining the effects the adoption will have on its Consolidated Financial Statements as well as whether to early adopt the new guidance.

In July 2017, the FASB issued Accounting Standards Update No. 2017-11, Earnings Per Share, Distinguishing Liabilities from Equity, Derivatives and Hedging, which changes the accounting treatment and the earnings per share calculation for certain instruments with down round features. The amendments in this update should be applied using a cumulative-effect adjustment as of the beginning of the fiscal year of adoption or retrospective adjustment to each period presented. This update is effective for annual periods beginning after December 15, 2018, and interim periods within those periods and early adoption is permitted. The Company is in the process of determining the impact the adoption will have on its Consolidated Financial Statements as well as whether to early adopt the new guidance.

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In August 2017, the FASB issued Accounting Standards Update No. 2017-12, Derivatives and Hedging, which is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting and increase transparency as to the scope and results of hedging programs. The amendments in this update will be applied using a cumulative-effect adjustment as of the beginning of the fiscal year of adoption. This update is effective for annual periods beginning after December 15, 2018, and interim periods within those periods and early adoption is permitted. The Company is in the process of determining the impact the adoption will have on its Consolidated Financial Statements as well as whether to early adopt the new guidance.

In March 2018, the FASB issued Accounting Standards Update No. 2018-05, Income taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, which provides guidance regarding the recording of tax impacts where uncertainty exists, in the period of adoption of the 2017 U.S. Tax Cuts and Jobs Act (the "Act"). To the extent that a company's accounting for certain income tax effects of the Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate to be included in the condensed financial statements. If a company cannot determine a provisional estimate to be included in the condensed financial statements, it should continue to apply ASC 740 on the basis of the provision of the tax laws that were in effect immediately before the enactment of the Act. See Note 8 to the Unaudited Consolidated Financial Statements for further discussion on the impact of the Act.

In June 2018, the FASB issued Accounting Standards Update No. 2018-07, Compensation – Stock Compensation, which aligns the measurement and classification guidance for share-based payment to non-employees with the guidance for share-based payments to employees. Under the new guidance, the measurement period for equity-classified non-employee awards will be fixed at the grant date. This update is effective for annual periods beginning after December 15, 2018, and interim periods within those periods and early adoption is permitted. The Company is in the process of determining the impact the adoption will have on its Consolidated Financial Statements as well as whether to early adopt the new guidance.

Recently Adopted Accounting Standards

In May 2014, the FASB issued Accounting Standard Update No. 2014-09 Revenue from Contracts with Customers ("ASU 2014-09"), an updated standard on revenue recognition. The standard effectively replaces Accounting Standards Codification 605 Revenue Recognition ("ASC 605") with ASC 606. In summary, the changes to the guidance in revenue recognition under ASC 606 focuses on the existence of a contract with the customer (whether written, oral, or implied by an entity's customary business practices), the concept that the performance obligation is fulfilled when the customer obtains control of the asset/service, versus the transfer of risk and reward, and the requirement that variable consideration (including rebates, discounts, etc.) and incremental costs must be estimated and recognized in the amount that is expected or most likely to be realized over the term of the contract fulfillment.

Prior to the adoption of ASC 606, the Company recognized revenue in accordance with ASC 605 when all four of the following criteria were met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured. Specifically, revenue from the sale of implants, biologics and disposables was generally recognized upon a purchase order from the hospital or acknowledgment from the hospital indicating product use or implantation or upon shipment to third-party customers who immediately accepted title. Revenue from the sale of instrument sets was recognized upon receipt of a purchase order and the subsequent shipment to customers who immediately accepted title. Revenue from neuromonitoring services was recognized in the period the service was performed for the amount of payment

expected to be received.

The Company adopted ASC 606 as of January 1, 2018, electing full retrospective method of adoption, which resulted in a change in its accounting policy for revenue recognition and related adjustments to the Consolidated Financial Statements for all periods presented. The Company applied the practical expedients permitted under ASC 606 for which (i) contracts with customers originating prior to January 1, 2016 do not require disclosure for the amount of consideration allocated to remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue; (ii) contracts beginning and completing in the same annual reporting period need not be restated; and (iii) hindsight for estimating variable consideration for completed contracts is permitted.

The Company recognizes revenue from spinal surgery hardware and ancillary products at a point in time in two types of transactions: (i) procedural based transactions with products used during surgery defined as “charge sheet orders”, and (ii) shipping transactions which represent the stocking of product or the purchase of instrumentation to support future surgeries defined as “stocking and capital orders”. The Company also recognizes revenue at a point in time associated with surgical-related servicing procedures, including neuromonitoring services which are defined as “surgical-related services”. Other sources of revenue, such as leasing revenue and royalties, are immaterial to the Consolidated Financial Statements.

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For charge sheet orders, the sale occurs when the surgery is performed and a charge sheet is submitted to the Company by its sales representative identifying the products consumed during the surgery. The charge sheet, as signed by the hospital, serves as a confirmation and acknowledgement of the Company's products consumed during a surgery. Under ASC 605, persuasive evidence of an arrangement and delivery of product was deemed to have occurred once the charge sheet was processed, and an associated authorization or acknowledgement from the customer was received. Under ASC 606, the Company's charge sheet orders are considered to be a contract with a customer when a surgery is scheduled with the Company as requested by the hospital or surgeon, and the products are consumed during the surgery or implanted into the patient. Revenue recognition under ASC 606 occurs upon completion of the Company's performance obligation, which occurs upon consumption of the products during surgery and receipt of the charge sheet. In the event that information related to the surgical event and consumption of product is not readily available the Company recognizes revenue upon a purchase order from the hospital or acknowledgment from the hospital indicating product use.

For stocking and capital orders, under ASC 605, delivery was deemed to have occurred when the title, including all risks and rewards of ownership of the products specified in the sales agreement had passed to the buyer. Accordingly, title, including all risks and rewards of ownership, passed based on the shipping terms. Under ASC 606, the Company's stocking and capital order performance obligation is considered to be satisfied when the hospital assumes control of the asset, either upon shipment or delivery depending on the terms, and ability to direct the use of the asset as appropriate without the Company's consent.

Under both ASC 605 and ASC 606, revenue from surgical-related services, such as neuromonitoring services, is recognized in the period the service is performed based on the delivery of a services report to the customer. The Company recognizes revenue for the amount of payment expected to be received. The Company bills either hospitals or insurance companies for different aspects of the service, as applicable. Revenue from hospitals is recognized based on agreed upon pricing. Revenue from insurance companies is recognized using the expected value method, as the Company bills at a gross rate which is generally not the rate ultimately collected.

Under ASC 605, the Company has historically estimated the amounts of returns, trade-ins, discounts, rebates, credits or incentives as offsets to the total transaction price or revenue associated with the sale. In limited situations, when historical information was not available or reliable, the Company would defer revenue recognition until completion of all performance obligations. Under ASC 606, the Company analyzes sales that could include variable consideration, and estimates the expected or most likely amount of revenue after returns, trade-ins, discounts, rebates, credits, and incentives. In making these estimates, the Company considers whether the amount of variable consideration is constrained and is included in revenue only to the extent that it is probable that a significant reversal of the revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

The Company earns sales-based royalty revenue over time from sales of products using existing biologics intellectual property ("IP") that is out-licensed to certain companies. Under ASC 605, royalty revenue was recognized as earned and when collection was reasonably assured and was generally estimated and recorded in the same period as the sales that generated the royalty obligation. ASC 606 provides an exception for sales or usage-based royalties from the guidance for accounting for variable consideration, allowing the royalty revenue from the license of IP to be recognized when the performance obligation has been satisfied and the subsequent sale has occurred. Therefore, the Company estimates monthly royalty revenue as its performance obligation is satisfied. The Company does not expect a significant impact to royalty revenue under the adoption of ASC 606 as it has historically estimated and accrued royalty revenue in the period earned.

The Company historically expensed incremental costs, such as commissions associated with sales contracts, as incurred. Under ASU 2014-09, ASC 340-40 Other Assets and Deferred Costs was added along with ASC 606 to codify accounting guidance for the incremental costs to obtain or fulfill a contract with a customer. Under the guidance, the incremental costs must be deferred and recorded over the period in which the contract revenue is recognized. The Company typically does not associate quarterly or annual sales bonuses directly with a sale or master contract; however, commissions are directly associated with individual sales and expensed in the same period as the related contract revenue. The associated commissionable sales would not typically have a future benefit unless the revenue is recognized over time. The Company does not typically have situations where revenue is deferred in excess of one year. Given the practical expedient for contracts completing within one year, the Company does not expect these capitalized costs to be material in a given period.

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The cumulative effect of the change on retained earnings for the full retrospective method of adoption of ASC 606 was \$0.3 million as of December 31, 2017. The following tables summarize in a condensed presentation the impact of the adoption of ASC 606 on the Company's previously reported Consolidated Balance Sheet as of December 31, 2017, the Unaudited Consolidated Statement of Operations and Comprehensive Income for the three and six months ended June 30, 2017, and the Unaudited Consolidated Statement of Cash Flows for the six months ended June 30, 2017.

NUVASIVE, INC.
CONSOLIDATED BALANCE SHEET
(in thousands)

	As	(Unaudited)	(Unaudited)
As of December 31, 2017	reported	Adjustments	As Adjusted
Accounts receivable, gross	\$212,709	\$ 537	[a] \$213,246
Allowances on accounts receivable	(13,669)	643	[b] (13,026)
Inventory, net	247,245	(107)	[c] 247,138
Other current assets	112,705	—	112,705
Total current assets	558,990	1,073	560,063
Remaining other assets	1,080,077	—	1,080,077
Total assets	\$1,639,067	\$ 1,073	\$ 1,640,140
Accounts payable and accrued liabilities	75,076	691	[d] 75,767
Accrued payroll and related expenses	55,582	36	[e] 55,618
Other current liabilities	30,010	—	30,010
Total current liabilities	160,668	727	161,395
Deferred and income tax liabilities, non-current	18,786	84	[f] 18,870
Other long-term liabilities	660,459	—	660,459
Total NuVasive, Inc. stockholders' equity	795,309	262	[g] 795,571
Non-controlling interests	3,845	—	3,845
Total equity	799,154	262	799,416
Total liabilities and equity	\$1,639,067	\$ 1,073	\$ 1,640,140

[a] Represents cumulative impact from January 1, 2016 to the period presented on accounts receivable for the full retrospective method of adoption of ASC 606.

[b] Represents cumulative impact from January 1, 2016 to the period presented on allowances on accounts receivable for the full retrospective method of adoption of ASC 606.

[c] Represents cumulative impact from January 1, 2016 to the period presented on inventory for the full retrospective method of adoption of ASC 606.

[d] Represents cumulative impact from January 1, 2016 to the period presented on commissions payable and accrued returns for the full retrospective method of adoption of ASC 606.

[e] Represents cumulative impact from January 1, 2016 to the period presented on commissions payable for the full retrospective method of adoption of ASC 606.

[f] Represents cumulative impact from January 1, 2016 to the period presented on deferred tax liabilities for the full retrospective method of adoption of ASC 606.

[g] Represents cumulative impact from January 1, 2016 to the period presented on retained earnings for the full retrospective method of adoption of ASC 606.

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NUVASIVE, INC.

CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

(Unaudited)	As reported	Adjustments	As adjusted
Three months ended June 30, 2017			
Revenue			
Product revenue	\$238,998	\$ (1,174)	[a] \$237,824
Service revenue	21,575	—	21,575
Total revenue	260,573	(1,174)	259,399
Cost of revenue (excluding amortization of intangible assets)			
Cost of products sold	50,770	(235)	[b] 50,535
Cost of services	15,651	—	15,651
Total cost of revenue	66,421	(235)	66,186
Gross profit	194,152	(939)	193,213
Operating expenses:			
Sales, marketing and administrative	139,109	(142)	[c] 138,967
Other operating expenses	25,290	—	25,290
Total operating expenses	164,399	(142)	164,257
Total interest and other expense, net	(10,445)	—	(10,445)
Income tax (expense) benefit	(7,079)	303	[d] (6,776)
Consolidated net income	\$12,229	\$ (494)	[e] \$11,735
Add back net loss attributable to non-controlling interests	\$(432)	\$ —	\$(432)
Net income attributable to NuVasive, Inc.	\$12,661	\$ (494)	[e] \$12,167
Net income per share attributable to NuVasive, Inc.:			
Basic	\$0.25	\$ (0.01)	[f] \$0.24
Diluted	\$0.22	\$ (0.01)	[f] \$0.21
Comprehensive income attributable to NuVasive, Inc.	\$13,304	\$ (494)	[e] \$12,810

[a] Represents net change in sales revenue for charge sheet orders recognized under ASC 606.

[b] Represents net change in cost of products sold for charge sheet orders recognized under ASC 606.

[c] Represents net change in accrued sales commissions for charge sheet orders recognized under ASC 606.

[d] Represents deferred income tax liability on net change associated with charge sheet orders recognized under ASC 606.

[e] Represents change in net income and comprehensive income resulting from net change in charge sheet orders recognized under ASC 606.

[f] Represents earnings per share impact resulting from net change in charge sheet orders recognized under ASC 606.

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NUVASIVE, INC.

CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

(Unaudited)	As reported	Adjustments	As adjusted
Six months ended June 30, 2017			
Revenue			
Product revenue	\$464,804	\$ (2,025)	[a] \$462,779
Service revenue	45,633	—	45,633
Total revenue	510,437	(2,025)	508,412
Cost of revenue (excluding amortization of intangible assets)			
Cost of products sold	96,841	(405)	[b] 96,436
Cost of services	31,193	—	31,193
Total cost of revenue	128,034	(405)	127,629
Gross profit	382,403	(1,620)	380,783
Operating expenses:			
Sales, marketing and administrative	279,611	(276)	[c] 279,335
Other operating expenses	49,820	—	49,820
Total operating expenses	329,431	(276)	329,155
Total interest and other expense, net	(19,849)	—	(19,849)
Income tax (expense) benefit			