HOMEAWAY INC
Form 4
August 05, 2013

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Baker Charles

(Last) (First) (Middle)

C/O HOMEAWAY, INC., 1011 W. FIFTH STREET, SUITE 300

(Street)

AUSTIN, TX 78703

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
HOMEAWAY INC [AWAY]

3. Date of Earliest Transaction (Month/Day/Year)
08/01/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	08/01/2013		A		1,427 (1)	A	$ 0	1,427	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. P De Sec (In
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Stock Option (Right to Buy)	$ 30.52	08/01/2013		A		7,472		(2)	08/01/2023	Common Stock	7,472	
Stock Option (Right to Buy)	$ 22.07							(3)	06/06/2022	Common Stock	13,514	

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Baker Charles C/O HOMEAWAY, INC. 1011 W. FIFTH STREET, SUITE 300 AUSTIN, TX 78703	X			

Signatures

Melissa Fruge (as Attorney-in-Fact for Charles Baker)	08/05/2013
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Represents restricted stock units awarded to the reporting person. 100% of the shares subject to the restricted stock units vest on the one-year anniversary of the vesting commencement date, such that the award will be fully-vested on August 1, 2014.

(2) 1/12 of the shares of common stock subject to the option vests each month following the vesting commencement date, such that the award will be fully-vested on August 1, 2014.

(3) Exercisable in twelve equal monthly installments beginning on the date of grant.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. d infrastructure services. In addition, other costs allocated to us include restructuring costs, share-based compensation expense and retirement plan expenses related to Integra's corporate and shared services employees. These operating expenses were allocated to us using estimates that we considered to be a reasonable

reflection of the utilization of services provided to or benefits received by us. We expect, however, that the actual expenses that we would have incurred had we been operating as a separate, publicly-traded company for the periods presented would have been lower, in the aggregate, as they would not include the allocation of the multi-year ERP implementation and other corporate strategic initiatives of Integra in place at the time. The allocation methods include pro-rata basis of revenue, standard cost of sales or other measures.

Integra will continue to provide some of these services related to these functions to us after the spin-off on a transitional basis for a fee. These services will be received under a transition services agreement described in the “Certain Relationships and Related Party Transactions” section of the Information Statement. In addition, certain costs associated with certain supply agreements with Integra discussed in the “Certain Relationships and Related Party Transactions” section of the Information Statement may be at materially different terms than those that were incurred while the business was part of Integra. Also, we expect to incur costs as an independent, publicly-traded company that are different from the costs historically allocated to us by Integra. We currently estimate the costs will be $13.0 million to $14.0 million on an annual pre-tax basis.

Subsequent to the spin-off, our unaudited interim condensed financial statements as of and for the three months ended September 30, 2015 are presented on a consolidated basis, as we became a separate publicly-traded company on July 1, 2015.

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We incurred $4.3 million and $19.1 million of non-recurring transaction and spin-off related costs and transition service fees from Integra in the three and nine months ended September 30, 2015, respectively. These costs include, among other things, branding, legal, accounting and other advisory fees and other costs to separate and transition from Integra.

Overview

We are a global medical technology company focused on the design, development and commercialization of surgical solutions for the treatment of patients suffering from spinal disorders. We have a comprehensive portfolio of orthobiologics and spinal fusion hardware solutions to meet the varying combinations of products that neurosurgeons and orthopedic spine surgeons need to perform fusion procedures in the lumbar, thoracic and cervical spine. We believe this broad combined portfolio of orthobiologics and spinal fusion hardware products is essential to meet the “complete solution” requirements of neurosurgeons and orthopedic spine surgeons.

We report revenue in two product categories: orthobiologics and spinal fusion hardware. Our orthobiologics products consist of a broad range of advanced and traditional bone graft substitutes that are designed to improve bone fusion rates following a wide range of orthopedic surgeries, including spine, hip, and extremities procedures. Our spinal fusion hardware portfolio consists of an extensive line of products to facilitate spinal fusion in minimally invasive surgery (“MIS”), complex spine, deformity and degenerative procedures.

Our U.S. sales organization consists of regional business managers who oversee a broad network of independent orthobiologics and spinal fusion hardware sales agents, to whom we consign and loan our products and pay commissions based on the sales of our products that they generate. These sales are generated by building and maintaining relationships with the neurosurgeons and orthopedic spine surgeons who use our products in surgeries or from the hospitals that order our products directly. Our international sales organization is composed of a sales management team that oversees a network of independent orthobiologics and spinal fusion hardware stocking distributors in over 30 countries that purchase products directly from us and independently sell them. For the nine months ended September 30, 2015, international sales accounted for approximately 10% of our revenue. Our policy is not to sell our products through or participate in physician-owned distributorships.

For the nine months ended September 30, 2015, our total revenue, net was $98.5 million and our net loss was $41.8 million. For the same period, our orthobiologics sales were $49.6 million, and our spinal fusion hardware sales were $48.9 million, each representing approximately 50% of our total revenue, net. We expect to continue to incur losses as we invest in the expansion of our business, primarily in marketing and research and development, and from the general and administrative expenses we expect to incur due to our operation as an independent, publicly-traded company. As of September 30, 2015, our cash balance was $38.5 million. In connection with the spin-off, Integra contributed $34.0 million in cash to us.

As of September 30, 2015, we had 279 employees.

Components of Our Results of Operations

Revenue

Our net revenue is derived primarily from the sale of orthobiologics and spinal fusion hardware products across North America, Europe, Asia Pacific and Latin America. Sales are reported net of returns, group purchasing organization fees and other customer allowances.

In the United States, we generate most of our revenue by consigning our orthobiologics products and consigning or loaning our spinal fusion hardware sets to hospitals and independent sales agents, who in turn deliver them to hospitals for a single surgical procedure, after which they are returned to us, or leave them with hospitals that are high volume users for multiple procedures. The spinal fusion hardware sets typically contain the instruments, including disposables, and spinal implants required to complete a surgery. We ship replacement inventory to independent sales agents to replace the consigned inventory used in surgeries and maintain and replenish loaned sets at our facility, and return them to a hospital or independent sales agent for the next procedure. We recognize revenue on these consigned or loaned products when they have been used or implanted in a surgical procedure.

For all other transactions, including sales to international stocking distributors, we recognize revenue when the products are shipped to the customer or stocking distributor and the transfer of title and risk of loss occurs. There is generally no customer acceptance or other condition that prevents us from recognizing revenue in accordance with the delivery terms.

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We entered into certain supply agreements with Integra prior to the spin-off, pursuant to which Integra will provide us with certain raw materials and we will provide each other with finished product for further sale in the operation of each other's business. These supply agreements are expected to modify our historical related party arrangements and reflect new pricing. See “Certain Relationships and Related Party Transactions" in the Information Statement.

Cost of Goods Sold

Cost of goods sold primarily consists of the costs of finished goods purchased directly from third parties and raw materials used in the manufacture of our products, plant and equipment overhead, labor costs, packaging costs, amortization of technology-related intangible assets and freight. The majority of our orthobiologics products are designed and manufactured internally. The cost of human tissue and fixed manufacturing overhead costs are significant drivers of the costs of goods sold and consequently our orthobiologics products, at current production volumes, generate lower gross profits than our spinal fusion hardware products. We rely on third-party suppliers to manufacture our spinal fusion hardware products, and we assemble them into surgical sets in-house. Other related costs included in cost of goods sold include royalties, shipping, inspection and charges for expired, excess and obsolete inventory. We expect our cost of goods sold to continue to increase in absolute dollars due primarily to increased sales volume.

Selling, General and Administrative Expense

Our selling, general and administrative (“SG&A”) expenses consist primarily of sales commissions to independent sales agents, cost of medical education and training, payroll and other headcount related expenses, depreciation and other expenses recorded against instrument sets, stock-based compensation, the Medical Device Excise Tax, marketing expenses, supply chain and distribution expenses, and expenses for information technology, legal, human resources, insurance, finance, facilities, and management, the substantial majority of which were allocated from Integra prior to the spin-off. Subsequent to the spin-off, we are incurring these administrative expenses directly as an independent, publicly-traded company.

We expect our SG&A expenses, excluding allocations from Integra incurred prior to the spin-off, to increase as we hire additional personnel to support the growth of our business, continue to expand our product portfolio and add related sales and marketing personnel, and as a result of being an independent, publicly-traded company.

Research and Development Expense

Our research and development (“R&D”) expenses primarily consist of expenses related to the headcount for engineering, product development, clinical affairs and regulatory functions as well as consulting services, third-party prototyping services, outside research and clinical studies activities, and materials, production and other costs associated with development of our products. We expense R&D costs as they are incurred.

We expect our R&D expenses to increase as we invest in the design and commercialization of new products. While our R&D expenses fluctuate from period to period based on the timing of specific initiatives, we expect that these costs will increase over time as we continue to expand our product portfolio, add related personnel and conduct clinical activities.

Intangible Amortization

Our intangible amortization, including the amounts reported in cost of goods sold, consists of acquisition-related amortization and impairments related to product discontinuations. We expect total annual amortization expense (including amounts reported in cost of goods sold) to be approximately $8.0 million in 2015, $7.0 million in 2016, $5.8 million in 2017, $5.5 million in 2018 and $4.8 million in 2019.

Other Income (Expense), Net

Other income (expense), net consists of non-operating items such as interest income, and foreign exchange transaction gains and losses on related party transactions and balances.

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RESULTS OF OPERATIONS

(In thousands, except percentages)	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Total revenue, net	$32,679	$33,606	$98,454	$103,547
Cost of goods sold	17,341	14,282	44,448	42,077
Gross profit	15,338	19,324	54,006	61,470
Gross profit %	46.9 %	57.5 %	54.9 %	59.4 %
Operating expenses:				
Selling, general and administrative	26,348	20,262	83,059	64,518
Research and development	2,364	2,111	5,973	6,259
Intangible amortization	1,295	1,397	4,049	4,174
Total operating expenses	30,007	23,770	93,081	74,951
Operating loss	(14,669)	(4,446)	(39,075)	(13,481)
Other income (expense), net	195	(30)	(577)	(59)
Loss before income taxes	(14,474)	(4,476)	(39,652)	(13,540)
Provision for income taxes	(275)	840	2,130	2,764
Net loss	$(14,199)	$(5,316)	$(41,782)	$(16,304)

Three Months Ended September 30, 2015 as Compared to Three Months Ended September 30, 2014

Revenue

For the three months ended September 30, 2015, total revenue, net decreased by $0.9 million, or 3%, to $32.7 million from $33.6 million for the same period in 2014.

	Three Months Ended September 30, 2015 (In millions)	Three Months Ended September 30, 2014
Orthobiologics	$16.5	$16.6
% of total revenue, net	50 %	49 %
Spinal Fusion Hardware	16.2	17.0
% of total revenue, net	50 %	51 %
Total revenue, net	$32.7	$33.6

Orthobiologics revenues were $16.5 million for the three months ended September 30, 2015, roughly flat compared to the three months ended September 30, 2014. Sales in the United States increased 2% compared to the prior year period, primarily because of increased demand for demineralized bone matrix products, especially our third-generation products and a recently launched product. This growth was somewhat offset by lower sales of our synthetic orthobiologics products in the United States. A decrease in international orthobiologics revenues compared to the prior year period more than offset the increase in domestic revenues. Supply shortages in our third-generation demineralized bone matrix products limited growth in the orthobiologics portfolio in the three months ended September 30, 2015. However, we expect that recent increases in production capacity and output have alleviated these supply issues and do not expect supply to limit growth for the remainder of 2015 or for 2016.

Spinal fusion hardware revenues were $16.2 million for the three months ended September 30, 2015, a decrease of 5% from the three months ended September 30, 2014. The U.S. hardware business continued to face pricing pressures and lower demand for existing products, while delays in introducing new products negatively impacted revenue in the current period. Sales of our spinal hardware fusion products internationally also decreased slightly for the three months ended September 30, 2015 as

Explanation of Responses:

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compared to the same period in 2014. We expect the performance of the hardware portfolio to improve in the fourth quarter as new product launches stimulate increased demand and as we begin to realize the benefits of recently added distributors and members of sales management.

The following table sets forth our total revenue, net by geography for the three months ended September 30, 2015 and 2014.

	Three Months Ended September 30,	
	2015	2014
	(In millions)	
United States	$30.1	$30.6
International	2.6	3.0
Total revenue, net	$32.7	$33.6

Cost of Goods Sold and Gross Profit

Cost of goods sold for the three months ended September 30, 2015 was $17.3 million compared to $14.3 million for the three months ended September 30, 2014. Gross profit as a percentage of revenues was 46.9% for the three months ended September 30, 2015 and 57.5% for the three months ended September 30, 2014. The decrease in gross profit percentage was mainly driven by a $4.4 million charge taken in the third quarter of 2015 for excess and obsolete spinal fusion hardware inventory, the substantial majority of which was purchased prior to the spin-off and a portion of which was primarily intended for distribution in international markets. During the third quarter ended September 30, 2015, we assessed our growth strategy for international markets, completed in the third quarter, following the spin-off. We now intend to deploy and invest our limited sales and marketing resources dedicated to international markets in a more targeted manner in fewer countries. As we introduce more new products in the future, we expect to leverage those new product launches to lead our international expansion activities. Primarily as a result of this shift in international strategy, we no longer expect that we will be able to sell the inventory against which we recorded the excess and obsolete inventory charge in the current period. This excess and obsolete inventory cost was somewhat offset by lower manufacturing costs resulting from increased production volumes and more efficient production of our orthobiologics product portfolio. Cost of goods sold included $0.7 million of amortization for technology-based intangible assets for each of the three months ended September 30, 2015 and 2014. Allocations from Integra accounted for $0.3 million for the three months ended September 30, 2014, and there was no such allocation for the three months ended September 30, 2015. As we further refine our global strategy post spin-off, we may identify additional risks related to inventory and other assets purchased or otherwise acquired prior to the spin-off that could be impaired by those decisions.

Selling, General and Administrative

SG&A expenses increased to $26.3 million for the three months ended September 30, 2015 from $20.3 million for the three months ended September 30, 2014. The increase in SG&A expenses was mainly driven by $2.5 million of nonrecurring professional fees directly related to the spin-off, $1.8 million of fees incurred under a transition services agreement with Integra, higher salary costs due to increased sales, marketing and administrative headcount, and increased costs associated with being an independent, publicly-traded company, such as higher stock- based compensation expense, and higher salary costs due to the hiring of an executive management team, medical device tax expenses and increased audit, legal, insurance, and information technology-related fees, offset by the absence of $4.2 million of allocation expense from Integra that was reported for the three months ended September 30, 2014.

Through the remainder of 2015, we expect to incur $1.0 million to $1.5 million of costs under a transition services agreement with Integra and expect to incur additional operational costs as we complete the remaining spin-off related projects. While the amount and timing of such costs may be significant and can vary from period to period, we do not expect to incur spin-off and transition service costs of a similar magnitude in future years.

Research and Development

R&D expenses increased $0.3 million to $2.4 million for the three months ended September 30, 2015 from $2.1 million for the same period in 2014. The increase of $0.3 million was primarily driven by higher compensation costs due to an increase in headcount, and higher external costs related to product development and clinical studies, offset by the absence of $0.1 million of allocation expense from Integra that was reported for the three months ended September 30, 2014. In future periods, we

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expect R&D expenses to increase as a percentage of revenues as we expand our product portfolio, add personnel and conduct additional clinical studies.

Intangible Amortization

Intangible amortization expense, excluding amounts reported in cost of goods sold for technology-based intangible assets, decreased $0.1 million to $1.3 million for the three months ended September 30, 2015 from $1.4 million for the same period in 2014, primarily due to non-compete agreements that were fully amortized during the second quarter of 2015.

Other Income (Expense), Net

Other income (expense), net increased $0.2 million to $0.2 million for the three months ended September 30, 2015, primarily as a result of interest income from money market funds and the positive impact of foreign exchange rates.

Income Taxes

	Three Months Ended September 30,	
	2015	2014
	(In thousands)	
Loss before income taxes	$(14,474)	$(4,476)
Provision for income taxes	(275)	840
Effective tax rate	1.9%	(18.8)%

Our effective tax rates were primarily driven by pretax losses incurred by our consolidated U.S. tax group that received no corresponding tax benefit because it is more-likely-than-not that we will be unable to realize the value of any resulting deferred tax assets.

We reported income tax expense for the three months ended September 30, 2014 related to the taxable income generated by its U.S. subsidiary that was not part of the U.S. consolidated tax group as of August 31, 2015. As such, despite the reported losses before income taxes in those periods, the taxable income generated by such U.S. subsidiary was not allowed to be offset against the taxable losses generated by its other U.S. subsidiaries through August 31, 2015. Effective September 1, 2015, the Company made an election that will allow it to offset any future taxable losses generated by its U.S. subsidiaries against any future taxable income generated by its U.S. subsidiaries. In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because we have concluded that it is more-likely-than-not that the Company will be unable to realize the value of any resulting deferred tax assets. The Company will continue to assess its position in future periods to determine if it is appropriate to reduce a portion of its valuation allowance in the future.

For the three months ended September 30, 2015, we recognized a $0.3 million benefit from the change in realizable deferred tax assets of a foreign subsidiary.

The income tax provision in the combined statements of operations for periods prior to the spinoff was calculated using the separate return method, as if the Company had filed a separate tax return and operated as a stand-alone business. However, because Integra historically generated taxable income in excess of our pretax losses incurred prior to the spinoff and all of our U.S. subsidiaries that incurred these pretax losses were included in Integra’s U.S. consolidated tax group, those pretax losses were more than offset by Integra’s taxable income. Therefore, there were no U.S. net operating losses available to us for future use at the date of the spin-off.

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Nine Months Ended September 30, 2015 as Compared to Nine Months Ended September 30, 2014

Revenue

For the nine months ended September 30, 2015, total revenue, net decreased by $5.1 million, or 5%, to $98.5 million from $103.5 million for the same period in 2014.

	Nine Months Ended September 30, 2015		2014	
	(In millions)			
Orthobiologics	$49.6		49.5	
% of total revenue, net	50	%	48	%
Spinal Fusion Hardware	48.9		54.0	
% of total revenue, net	50	%	52	%
Total revenue, net	$98.5		$103.5	

Orthobiologics revenues were $49.6 million for the nine months ended September 30, 2015, roughly flat as compared to the nine months ended September 30, 2014. Sales in the United States increased primarily because of increased demand for demineralized bone matrix products, especially our third-generation products and a recently launched product. This growth was somewhat offset by lower sales of our synthetic orthobiologics products in the United States. A decrease in international orthobiologics revenues compared to the prior year period further offset the increase in domestic orthobiologics revenues. Supply shortages in our third-generation demineralized bone matrix products limited growth in the orthobiologics portfolio in the nine months ended September 30, 2015. However, we expect that recent increases in production capacity and output have alleviated these supply issues and do not expect supply to limit growth for the remainder of 2015 or for 2016.

Spinal fusion hardware revenues were $48.9 million for the nine months ended September 30, 2015, a decrease of 9% from the nine months ended September 30, 2014. The U.S. hardware business continued to face pricing pressures and lower demand for existing products, while delays in introducing some of our new products negatively impacted revenue in the current period. International sales of our spinal hardware fusion products were relatively flat over the nine months ended September 30, 2015 and 2014. We expect the performance of the hardware portfolio to improve in the fourth quarter as new product launches stimulate increased demand and as we begin to realize the benefits of recently added distributors and members of sales management.

The following table sets forth our total revenue, net by geography for the nine months ended September 30, 2015 and 2014.

	Nine Months Ended September 30, 2015	2014
	(In millions)	
United States	$89.1	$93.4
International	9.4	10.1
Total revenue, net	$98.5	$103.5

Cost of Goods Sold and Gross Profit

Cost of goods sold for the nine months ended September 30, 2015 increased $2.4 million to $44.4 million compared to the nine months ended September 30, 2014. Gross profit as a percentage of revenues was 54.9% for the nine months ended September 30, 2015 and 59.4% for the nine months ended September 30, 2014. The decrease in gross profit percentage was mainly driven by a higher percentage of sales being derived from orthobiologics products, which have lower gross profit than our hardware products, and by $4.0 million of higher charges for excess and obsolete spinal fusion hardware inventory, the largest of which was recorded in the three months ended September 30, 2015 and a portion of which was primarily related to inventory for sale in international markets. These costs were partially offset by lower manufacturing costs in 2015 resulting

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Explanation of Responses:

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from increased production volumes and more efficient production of our orthobiologics product portfolio, and a nonrecurring charge recorded in 2014 related to a discontinued product line. Cost of goods sold included $2.0 million of amortization for technology-based intangible assets for each of the nine months ended September 30, 2015 and 2014. Allocations from Integra accounted for $0.5 million of expense for the nine months ended September 30, 2015 as compared to $1.0 million for the nine months ended September 30, 2014.

Selling, General and Administrative

SG&A expenses increased to $83.1 million for the nine months ended September 30, 2015 from $64.5 million for the nine months ended September 30, 2014. The increase in SG&A expenses was mainly driven by $18.6 million of nonrecurring spin-off related charges, $1.8 million of fees incurred under a transition services agreement with Integra, higher salary costs due to increased sales, marketing and administrative headcount, and increased costs associated with being an independent, publicly-traded company, such as higher stock-based compensation expense, higher salary costs due to the hiring of an executive management team, medical device tax expenses, and increased audit, legal, insurance, and information technology-related fees, offset by a reduction of $5.4 million allocation from Integra. Allocations from Integra accounted for $8.6 million of expense for the nine months ended September 30, 2015, as compared to $14.0 million for the nine months ended September 30, 2014.

Research and Development

R&D expenses decreased $0.3 million to $6.0 million for the nine months ended September 30, 2015 compared to $6.3 million for the nine months ended September 30, 2014. The decrease in R&D expenses during the nine months ended September 30, 2015 was primarily derived from lower outside project spending and from Integra's shifting R&D investments to other areas of its business prior to the spin-off. Allocations from Integra were essentially flat at $0.3 million for the nine months ended September 30, 2015 and 2014.

Intangible Amortization

Intangible amortization expense, excluding amounts reported in cost of goods sold for technology-based intangible assets, decreased $0.1 million to $4.0 million for the nine months ended September 30, 2015 compared to the same period in 2014, primarily due to non-compete agreements that were fully amortized during the second quarter of 2015.

Other Income (Expense), Net

Other expense, net increased $0.5 million to $0.6 million for the nine months ended September 30, 2015, as compared to the nine months ended September 30, 2014, primarily due to the negative impact of foreign exchange rates on related party loans.

Income Taxes

	Nine Months Ended September 30,	
	2015	2014
	(In thousands)	
Loss before income taxes	$(39,652)	$(13,540)
Provision for income taxes	2,130	2,764
Effective tax rate	(5.4)%	(20.4)%

The primary drivers of the effective tax rate for the nine months ended September 30, 2015 and 2014 were pretax losses incurred by the consolidated U.S. tax group that received no corresponding tax benefit and pretax income incurred by a U.S. subsidiary not included in the Company’s U.S. consolidated federal income tax return.

We reported income tax expense for the nine months ended September 30, 2015 and 2014 related to the taxable income generated by its U.S. subsidiary that was not part of the U.S. consolidated tax group as of August 31, 2015. As such, despite the reported losses before income taxes in those periods, the taxable income generated by such U.S. subsidiary was not allowed to be offset against the taxable losses generated by its other U.S. subsidiaries through August 31, 2015. Effective September 1, 2015, the Company made an election that will allow it to offset any future taxable losses generated by its U.S. subsidiaries against any future taxable income generated by its U.S. subsidiaries. In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because we have concluded that it is more-likely-than-not that the Company will be unable to realize the value of any resulting deferred tax assets. The Company will

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continue to assess its position in future periods to determine if it is appropriate to reduce a portion of its valuation allowance in the future.

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Business Factors Affecting the Results of Operations

Special Charges

We define special charges as expenses for which the amount or timing can vary significantly from period to period, and for which the amounts are non-cash in nature, or the amounts are not expected to recur at the same magnitude. We believe that identification of these special charges provides important supplemental information to investors regarding financial and business trends relating to our financial condition and results of operations. Investors may find this information useful in assessing comparability of our operating performance from period to period, against the business model objectives that management has established, and against other companies in our industry. We provide this information to investors so that they can analyze our operating results in the same way that management does and use this information in their assessment of the core business and valuation of SeaSpine.

Loss before income taxes includes the following special charges:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)		(In thousands)	
Global ERP implementation charges	$—	$23	$95	$108
SeaSpine spin-off related charges	2,500	148	17,278	148
Transition services agreement charges	1,800	—	1,800	—
Discontinued product line charges	—	147	—	860
Acquisition-related charges	—	96	—	165
Total	$4,300	$414	$19,173	$1,281

The items reported above are reflected in the condensed consolidated and combined statements of operations as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)		(In thousands)	
Cost of goods sold	$436	$243	$563	$1,025
Selling, general and administrative	3,864	171	18,610	256
Total	$4,300	$414	$19,173	$1,281

These special charges are directly related to the SeaSpine business and do not include allocations from Integra. Global ERP implementation charges consist of the non-capitalizable portion of internal labor and outside consulting costs related to the implementation of a global ERP system for SeaSpine, which was completed in May 2015. SeaSpine spin-off related charges include legal, accounting, program management and outside consulting expenses incurred as part of the spin-off from Integra, and incremental personnel costs associated with becoming an independent, publicly-traded company. Discontinued product line charges are related to the exit of one of our product lines sold internationally. Acquisition-related charges include transaction fees and the amortization of inventory fair value adjustments related to acquisitions.

Liquidity and Capital Resources

Overview

Historically, Integra provided financing, cash management and other treasury services to us. Prior to the spin-off, we transferred the majority of cash from operations to Integra and accordingly we generally had no significant cash. With the implementation of our own global ERP system on May 4, 2015, we began to collect against our own accounts receivable, including accounts receivable with Integra, and to directly pay some of our obligations. Effective with the spin-off, we no longer transfer any of our cash to Integra and began to directly pay all of our obligations. Cash historically transferred to and from Integra prior to the spin-off has been reflected in the combined statement of cash flows as a financing activity and in the combined balance sheet through Integra net investment in us.

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We believe that our cash and cash equivalents, and the borrowing capacity that we expect to have under a credit facility that we expect to enter into in the fourth quarter of 2015, will be sufficient to fund our operations for at least the next twelve months.

Our estimate of the period of time through which our current financial resources will be adequate to support our operations are
forward-looking statements based on significant assumptions and we could utilize our financial resources sooner than we
currently expect. Forward-looking statements involve a number of risks and uncertainties and actual results could differ materially if the assumptions on which we have based our forward-looking statements prove to be wrong.
Factors that will affect our operating expenses and future capital requirements include, but are not limited to:

- the costs associated with designing and developing new products, including modifications to our existing products;
- the design, initiation, scope, rate of progress, results and timing of any clinical studies we conduct;
- the successful completion of our product development programs and our ability to manage costs associated with the development and commercialization of new products;
- our ability to timely obtain and maintain regulatory clearance or approval of our existing and new products;
- the rate at which we launch and commercialize products and the extent of their commercial success;
- our ability to manage timelines and costs related to manufacturing our products;
- the extent to which we increase our employee workforce and/or number of independent sales agent, including in connection with expanding our product portfolios;
- the costs required to build out our new Carlsbad, CA facility and to complete the move of existing operations from our Vista, CA facilities;
- our ability to protect our intellectual property and operate our business without infringing upon the intellectual property rights of others; and
- the extent to which we seek to expand through acquisitions and execute on transactions intended to do so.
- whether we enter into and the timing and terms of the credit facility that currently we are negotiating.

Cash and Cash Equivalents

We had cash and cash equivalents totaling approximately $38.5 million and $0.7 million at September 30, 2015 and December 31, 2014, respectively.

Cash Flows

	Nine Months Ended September 30,	
	2015	2014
	(In thousands)	
Net cash (used in) provided by operating activities	$(29,451)	$4,940
Net cash used in investing activities	(9,976)	(2,343)
Net cash provided by (used in) financing activities	77,210	(2,587)
Effect of exchange rate fluctuations on cash	68	(2)
Net increase in cash and cash equivalents	$37,851	$8

Net Cash Flows Provided by (Used in) Operating Activities

We used $29.5 million and generated operating cash flows of $4.9 million for the nine months ended September 30, 2015 and 2014, respectively.

Operating cash outflows for the nine months ended September 30, 2015 increased by $34.4 million compared to the nine months ended September 30, 2014. Net loss plus adjustments to reconcile net loss to net cash (used in) provided by operating activities decreased cash flows by $22.0 million, largely driven by spin-off related charges. Among the changes in working capital, purchases of inventory used $7.4 million more of cash, prepaid insurance and other assets primarily related to the commencement of our activities as a separate, publicly-traded company used $1.3 million more of cash in 2015. The increase in accounts receivable also used $2.1 million of cash in 2015.

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Net Cash Flows Used in Investing Activities

Net cash used in investing activities was $10.0 million for the nine months ended September 30, 2015 as compared to $2.3 million for the nine months ended September 30, 2014. The increased use of cash was primarily attributable to the implementation of a global ERP system and new hardware and software required to meet our needs after the spin-off, $3.0 million of purchases of spinal fusion hardware sets and instruments related to existing products and planned new product launches, and a milestone payment related to the NeuroStructures license agreement.

During the nine months ended September 30, 2014, we paid $2.3 million for capital expenditures, most of which was purchases of spinal fusion hardware set and instruments.

Net Cash Flows Provided by (Used in) Financing Activities

Net cash provided by financing activities was $77.2 million for the nine months ended September 30, 2015 as compared to net cash used in financing activities of $2.6 million for the nine months ended September 30, 2014. The increase in cash resulted from a higher investment from Integra and the $34 million cash contribution in connection with the spin-off.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements as of September 30, 2015 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our business.

Contractual Obligations and Commitments

As of September 30, 2015, we were obligated to pay the following amounts under various agreements:

		Payments Due by Calendar Year			
	Total	Remaining 2015	2016-2017	2018-2019	Thereafter
	(In millions)				
Employment Agreements	$1.8	$0.2	$1.0	$0.6	$—
Operating Leases	26.4	0.6	4.8	4.9	16.1
Purchase Obligations	2.3	0.1	0.8	0.9	0.5
Other	3.5	3.5	—	—	—
Total	$34.0	$4.4	$6.6	$6.4	$16.6

Excluded from the table is the liability for uncertain tax benefits, including interest and penalties, totaling less than $0.3 million. This liability for uncertain tax benefits has been excluded because we cannot make a reliable estimate of the period in which such liability may be realized. "Other" includes minimum royalty, warranty obligation and capital leases.

Other Matters

Critical Accounting Estimates

The critical accounting estimates disclosed in the Information Statement have not materially changed.

Recently Issued Accounting Pronouncements

Information regarding new accounting pronouncements is included in Note 2, "Summary of Significant Accounting Policies," to the Notes to Unaudited Condensed Consolidated and Combined Financial Statements included elsewhere in this report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks, including changes in foreign currency exchange rates and interest rates that could adversely affect our results of operations and financial condition. Although we do not have any derivative instruments for hedging purposes, to manage the volatility relating to these typical business exposures, we may consider entering into various derivative transactions when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes.

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Foreign Currency Exchange and Other Rate Risks

During the nine months ended September 30, 2015 and September 30, 2014, we generated revenues outside the United States in multiple foreign currencies including euros, British pounds, Swiss francs and New Zealand dollars, and in U.S. dollar-denominated transactions conducted with customers who generated revenue in currencies other than the U.S. dollar. We also incur operating expenses in euros. As a result, changes in the exchange rates of any such foreign currency vs. the U.S. dollar may affect our revenues, gross profits and net income and may also affect the book value of our assets and the amount of stockholders' equity. We cannot predict the consolidated effects of exchange rate fluctuations upon our future operating results because of the variability of foreign currency exposure in our revenues and operating expenses and the potential volatility of currency exchange rates.

Interest Rate Risk

As of September 30, 2015, we did not have any outstanding debt or derivative instruments, and therefore we were not exposed to interest rate risk. However, we will be exposed to interest rate risk in connection with any future borrowings that we may enter into, including a credit facility that we expect to enter into in the fourth quarter of 2015.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the direction of our Chief Executive Officer and Chief Financial Officer, we evaluated our disclosure controls and procedures and concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) under the Securities and Exchange Act of 1934, as amended, that occurred during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are subject to legal proceedings and claims in the ordinary course of business. While management presently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not materially harm our financial position, cash flows, or overall trends in results of operations, legal proceedings are subject to inherent uncertainties, and unfavorable rulings or outcomes could occur that have individually or in aggregate, a material adverse effect on our business, financial condition or operating results.

ITEM 1A. RISK FACTORS

The Risk Factors included in our Registration Statement on Form 10, as amended, filed with the SEC on June 9, 2015 have not materially changed.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

10.1	Sublease Agreement between SeaSpine Orthopedics Corporation, and SkinMedica, Inc., dated as of July 8, 2015 (incorporated by reference to Exhibit 10.1 of the Company’s Current Report on Form 8-K filed on September 11, 2015).
*31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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*†101.INS	XBRL Instance Document
*†101.SCH	XBRL Taxonomy Extension Schema Document
*†101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*†101.DEF	XBRL Definition Linkbase Document
*†101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
*†101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

† The financial information of SeaSpine Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2015 filed on November 12, 2015 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated and Combined Statements of Operations, (ii) Condensed Combined Statements of Comprehensive Loss, (iii) the Condensed Consolidated and Combined Balance Sheets, (iv) Parenthetical Data to the Condensed Consolidated and Combined Balance Sheets, (v) the Condensed Consolidated and Combined Statements of Cash Flows, (vi) the Condensed Consolidated and Combined Statement of Equity, and (vii) Notes to Unaudited Condensed Consolidated and Combined Financial Statements, is furnished electronically herewith.

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SIGNATURES

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

	SEASPINE HOLDINGS CORPORATION
Date: November 12, 2015	/s/ Keith C. Valentine Keith C. Valentine President and Chief Executive Officer
Date: November 12, 2015	/s/ John J. Bostjancic John J. Bostjancic Chief Financial Officer

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