SeaSpine Holdings Corp
Form 10-Q
May 16, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2016
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
COMMISSION FILE NO. 001-36905

SeaSpine Holdings Corporation
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	47-3251758
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
5770 Armada Drive, Carlsbad, California	92008
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (760) 727-8399

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 x No o

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

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

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

The number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of May 2, 2016 was 11,092,931.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31, 2016	2015
Total revenue, net	$31,399	$32,314
Cost of goods sold	14,283	12,601
Gross profit	17,116	19,713
Operating expenses:		
Selling, general and administrative	25,374	25,051
Research and development	2,753	1,582
Intangible amortization	1,281	1,397
Total operating expenses	29,408	28,030
Operating loss	(12,292)	(8,317)
Other income (expense), net	258	(721)
Loss before income taxes	(12,034)	(9,038)
Provision (benefit) for income taxes	(27)	860
Net loss	$(12,007)	$(9,898)
Net loss per share, basic and diluted	$(1.08)	$(0.90)
Weighted average shares used to compute basic and diluted net loss per share	11,167	11,048

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

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SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)
(In thousands)

	Three Months Ended March 31, 2016	2015
Net loss	$(12,007)	$(9,898)
Other comprehensive income		
Foreign currency translation adjustments	190	63
Comprehensive loss	$(11,817)	$(9,835)

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

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SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except par value data)

	March 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$28,602	$ 33,429
Trade accounts receivable, net of allowances of $588 and $764	22,893	25,326
Inventories	50,309	51,271
Prepaid expenses and other current assets	2,165	3,696
Total current assets	103,969	113,722
Property, plant and equipment, net	21,051	21,958
Intangible assets, net	37,677	39,632
Other assets	1,007	1,077
Total assets	$163,704	$ 176,389
LIABILITIES AND INVESTED EQUITY		
Current liabilities:		
Accounts payable, trade	$11,185	$ 13,689
Accrued compensation	3,948	4,177
Accrued commissions	4,029	4,227
Accrued expenses and other current liabilities	3,906	3,942
Total current liabilities	23,068	26,035
Long-term borrowings under credit facility	361	328
Other liabilities	2,908	2,687
Total liabilities	26,337	29,050
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 15,000 authorized; none issued and outstanding	—	—
Common stock, $0.01 par value; 60,000 authorized; 11,093 shares issued and outstanding at March 31, 2016, and 11,102 shares issued and outstanding at December 31, 2015	111	111
Additional paid-in capital	175,631	173,786
Accumulated other comprehensive income	1,581	1,391
Accumulated deficit	(39,956)	(27,949)
Total stockholders' equity	137,367	147,339
Total liabilities and stockholders' equity	$163,704	$ 176,389

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

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SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended March 31, 2016			2015		
OPERATING ACTIVITIES:						
Net loss	$	(12,007	)	$	(9,898	)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:						
Depreciation and amortization	3,162			3,005		
Instrument replacement expense	589			200		
Impairment of instruments	103			—		
Provision for excess and obsolete inventories	2,525			430		
Amortization of debt issuance costs	35			—		
Deferred income tax benefit	(35		)	—		
Stock-based compensation	1,974			89		
Allocation of non-cash charges from Integra	—			247		
Changes in assets and liabilities						
Accounts receivable	2,551			2,525		
Inventories	(1,022		)	846		
Prepaid expenses and other current assets	1,534			362		
Other non-current assets	101			(4		)
Accounts payable	(3,394		)	676		
Income taxes payable	—			(157		)
Accrued commissions	(200		)	(478		)
Accrued compensation, accrued expenses and other current liabilities	(277		)	2,866		
Other non-current liabilities	170			(101		)
Net cash (used in) provided by operating	(4,191		)	608		

activities						
INVESTING ACTIVITIES:						
Purchases of property and equipment	(983		)	(3,571		)
Net cash used in investing activities	(983		)	(3,571		)
FINANCING ACTIVITIES:						
Other financing activity	(2		)	—		
Integra net investment prior to the spin-off	—			2,962		
Net cash (used in) provided by financing activities	(2		)	2,962		
Effect of exchange rate changes on cash and cash equivalents	349			(3		)
Net change in cash and cash equivalents	(4,827		)	(4		)
Cash and cash equivalents at beginning of period	33,429			652		
Cash and cash equivalents at end of period	$	28,602		$	648	
Non-cash investing activities:						
Property and equipment in liabilities	998			541		

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

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SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF EQUITY
(Unaudited)
(In thousands)

	Common Stock		Additional	Accumulated Other		Total
	Number of Shares	Amount	Paid-In Capital	Comprehensive Income	Accumulated Deficit	Stockholder's Equity
Balance December 31, 2015	11,102	$ 111	$ 173,786	$ 1,391	$ (27,949)	$ 147,339
Net loss	—	—	—	—	(12,007)	(12,007)
Foreign currency translation adjustment	—	—	—	190	—	190
Restricted stock awards forfeited	(9)	—	(129)	—	—	(129)
Stock-based compensation	—	—	1,974	—	—	1,974
Balance March 31, 2016	11,093	$ 111	$ 175,631	$ 1,581	$ (39,956)	$ 137,367

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

SEASPINE HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS
Spin-off from Integra
As of June 30, 2015, SeaSpine Holdings Corporation ("SeaSpine", or the "Company") was a subsidiary of Integra LifeSciences Holdings Corporation (“Integra”). On July 1, 2015, Integra completed the spin-off of its orthobiologics and spinal fusion hardware business into SeaSpine, which was created to be a separate, independent, publicly-traded medical technology company focused on the design, development and commercialization of surgical solutions for the treatment of patients suffering from spinal disorders. Unless the context indicates otherwise, (i) references to "SeaSpine", the "Company", and the "Business", refer to SeaSpine Holdings Corporation and its orthobiologics and spinal fusion hardware business and (ii) references to "Integra" refer to Integra LifeSciences Holdings Corporation and its subsidiaries other than SeaSpine.

The SeaSpine Registration Statement on Form 10 became effective on June 9, 2015, and SeaSpine common stock began “regular-way” trading on the NASDAQ Global Market on July 2, 2015 under the symbol “SPNE.”

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Company prepared the unaudited interim condensed consolidated financial statements included in this report in accordance with accounting principles generally accepted in the U.S. (“GAAP”). For periods prior to the spin-off, the Company’s consolidated financial statements were prepared on a stand-alone basis and derived from Integra's consolidated financial statements and accounting records related to its orthobiologics and spinal fusion hardware business. The Company relied on Integra for a significant portion of its operational and administrative support. The consolidated financial statements for all periods prior to the spin-off included allocations of certain Integra corporate expenses, including information technology resources and support; finance, accounting, auditing services; real estate and facility management services; human resources activities; certain procurement activities; treasury services, legal advisory services and costs for research and development. These costs were allocated to the Company on the basis of direct usage when identifiable, with the remainder allocated on a pro-rata basis of revenue, standard costs of sales, or other measures.
Integra used a centralized approach to cash management and financing of its operations and substantially all cash generated by the Company through May 4, 2015, the date the Company implemented a separate enterprise resource planning ("ERP") system for SeaSpine, was assumed to be remitted to Integra. Prior to the spin-off, cash management and financing transactions relating to the Company were accounted for through the Integra invested equity account. Accordingly, none of the Integra cash and cash equivalents at the corporate level were assigned to SeaSpine in the consolidated financial statements. Integra’s debt and related interest expense were not allocated to SeaSpine for any of the periods presented since the Company was not the legal obligor of the debt and Integra’s borrowings were not directly attributable to SeaSpine.
Subsequent to the spin-off, the Company’s financial statements are presented on a consolidated basis, as the Company became a separate publicly-traded company on July 1, 2015. In the opinion of management, the March 31, 2016 unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows of the Company. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2015 included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC. The Company's consolidated balance

sheet as of December 31, 2015 was derived from audited financial statements, but does not include all disclosures required by GAAP. The Company performs its operational and administrative support using internal resources and purchased services, some of which have been provided by Integra for a fee pursuant to a transition services agreement. See Note 4, “Transactions with Integra,” for further information regarding the relationships the Company has with Integra.

Principles of Consolidation

For periods prior to the spin-off, the consolidated financial statements include certain assets and liabilities that have historically been held at the Integra level but were specifically identifiable or otherwise attributable to the Company. All significant intra-company transactions within Integra's pre-spin off orthobiologics and spinal fusion hardware business have been eliminated. All

SEASPINE HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

significant transactions between the Company and other businesses of Integra before the spin-off are included in these condensed consolidated financial statements.

For periods subsequent to the spin-off, the consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should: 1) identify the contract(s) with a customer, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. In July 2015, the FASB deferred for one year the effective date of the new revenue standard, but early adoption is permitted. The new standard will be effective for the Company on January 1, 2018. The Company is in the process of evaluating the impact of this standard on its financial statements.

In August 2014, the FASB issued Update No. 2014-15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The amendment requires management to evaluate, for each annual and interim reporting period, whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern within one year after the date the financial statements are issued or are available to be issued. If substantial doubt is raised, additional disclosures around management’s plan to alleviate these doubts are required. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2016. The implementation of the amended guidance is not expected to have an impact on current disclosures in our financial statements.

In April 2015, the FASB issued Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs. The new standard will require debt issuance costs to be presented on the balance sheet as a direct reduction of the carrying value of the associated debt liability, consistent with the presentation of debt discounts. The recognition and measurement requirements will not change as a result of this guidance. The standard is effective for the annual reporting periods beginning after December 15, 2015 and requires a retrospective application. The guidance in Accounting Standards Update ("ASU") 2015-03 does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. In August 2015, the FASB issued ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. Under the new standard, the SEC staff will not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The implementation of the amended guidance did not have an impact on current disclosures in our financial statements.

In July 2015, the FASB issued Update No. 2015-11, Simplifying the Measurement of Inventory (Topic 330). The new guidance requires an entity to measure inventory within the scope of the amendment at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The implementation of the amended guidance is not expected to have an impact on our financial statements.

In November 2015, the FASB issued Update No. 2015-17, Income Taxes - Balance Sheet Reclassification of Deferred Taxes (Topic 740). This ASU requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this update. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted and the amendments may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The Company early adopted this ASU in the fourth quarter of 2015 on a prospective basis. The Company did not adjust our prior period consolidated balance sheet as a result of the adoption of this ASU.

In February 2016, the FASB issued Update No. 2016-02, Leases (Topic 842), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months

SEASPINE HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. Topic 842 supersedes the previous leases standard, Topic 840 Leases. The standard is effective on January 1, 2019, with early adoption permitted. The Company is in the process of evaluating the impact of this new guidance.

In March 2016, the FASB issued Update No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718). Under current accounting guidance an entity is required to report excess tax benefits and tax deficiencies to the extent of previous windfalls in equity when the tax benefit is realized. Excess settlements are currently reported as cash inflows from financing activities. The amendment requires that an entity present all excess tax benefits and all tax deficiencies as income tax expense or benefit in the statement of operations to be applied using a prospective transition method. Related tax settlements are to be presented as cash inflows from operating activities. The Company has the option to use either a prospective or retrospective transition method. The amendment removes the requirement to delay recognition of an excess tax benefit until the tax benefit is realized. A modified retrospective transition method must be applied. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

Net Loss Per Share

For periods prior to the spin-off, basic and diluted net loss per share was calculated based on the approximately 11.0 million shares of SeaSpine common stock that were distributed to Integra shareholders on July 1, 2015. For periods subsequent to the spin-off, basic and diluted net loss per share was calculated using the weighted-average number of shares of common stock outstanding during the period. The weighted average number of shares used to compute diluted net loss per share excludes any assumed exercise of stock options, and any assumed issuance of common stock under restricted stock units as the effect would be antidilutive. Common stock equivalents of 2.7 million shares for the three months ended March 31, 2016 were excluded from the calculation because of their antidilutive effect.

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except per share data)	
Net loss	$(12,007)	$(9,898)
Loss Per Share Data		
Loss per share		
Basic and diluted	$(1.08)	$(0.90)
Weighted average number of shares outstanding		
Basic and diluted	11,167	11,048

Out-of-Period Adjustment

In the second quarter of 2015, the Company recorded an adjustment to correct an error in the first quarter of 2015 reported amounts. This resulted in an increase to finished goods inventory and Integra's net investment by $0.7 million. In addition to understating the inventory balance and net investment balance as of March 31, 2015, the error had the effect of increasing first quarter cash flows from operations and decreasing first quarter cash flows from financing by $0.7 million. The adjustment recorded in the second quarter of 2015 corrects the year to date cash flows from operations and cash flows from financing. The Company retrospectively adjusted the Condensed Consolidated Statement of Cash Flows for the period ended March 31, 2015.

3. CREDIT AGREEMENT

On December 24, 2015, the Company entered into a three-year credit facility (the "Credit Facility") with Wells Fargo Capital Finance. The Credit Facility provides an asset-backed revolving line of credit of up to $30.0 million in borrowing capacity with a maturity date of December 24, 2018, which maturity date is subject to a one-time one