

NATUS MEDICAL INC  
Form 10-K  
February 29, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ý Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended  
December 31, 2015  
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: 000-33001

NATUS MEDICAL INCORPORATED

(Exact name of Registrant as specified in its charter)

Delaware

77-0154833

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

6701 Koll Center Parkway, Suite 120, Pleasanton, CA 94566

(Address of principal executive offices) (Zip Code)

(925) 223-6700

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, \$0.001 par value per share

The NASDAQ Stock Market LLC

(Nasdaq Global Select Market)

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ..

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes .. No ý

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 requirements for the past 90 days. Yes ý No ..

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 ý No ..

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. ý

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

Large accelerated filer ý

Accelerated filer ..

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Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

As of June 30, 2015, the last business day of Registrant's most recently completed second fiscal quarter, there were 33,084,167 shares of Registrant's common stock outstanding, and the aggregate market value of such shares held by non-affiliates of Registrant (based upon the closing sale price of such shares on the Nasdaq Global Select Market on June 30, 2015) was \$1,408,062,148. Shares of Registrant's common stock held by each executive officer and director and by each entity that owns 5% or more of Registrant's outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On February 22, 2016, the registrant had 33,155,154 shares of its common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

The Registrant has incorporated by reference, into Part III of this Form 10-K, portions of its Proxy Statement for the 2016 Annual Meeting of Stockholders.

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ANNUAL REPORT ON FORM 10-K  
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### PART I

#### ITEM 1. Business

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 about Natus Medical Incorporated (“Natus,” “we,” “us,” or “our Company”). These statements include, among other things, statements concerning our expectations, beliefs, plans, intentions, future operations, financial condition and prospects, and business strategies. The words “may,” “will,” “continue,” “estimate,” “project,” “intend,” “believe,” “expect,” “anticipate,” and other similar expressions generally identify forward-looking statements. Forward-looking statements in this Item 1 include, but are not limited to, statements regarding the effectiveness and advantages of our products, factors relating to demand for and economic advantages of our products, our plan to develop and acquire additional technologies, products or businesses, our marketing, technology enhancement, and product development strategies, and our ability to complete all of our backlog orders.

Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause our actual results to differ materially from those that we predicted in the forward-looking statements. Investors should carefully review the information contained under the caption “Risk Factors” contained in Item 1A for a description of risks and uncertainties that could cause actual results to differ from those that we predicted. All forward-looking statements are based on information available to us on the date hereof, and we assume no obligation to update forward-looking statements, except as required by Federal Securities laws.

“Natus” and other trademarks of ours appearing in this report are our property.

#### Overview

Natus is a leading provider of newborn care and neurology healthcare products and services used for the screening, diagnosis, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, neuromuscular diseases and balance and mobility disorders.

#### Product Families

We are organized into two strategic business units, each with multiple product families:

**Neurology**—Includes products and services for diagnostic electroencephalography (“EEG”) and long term monitoring (“LTM”), Intensive Care Unit (“ICU”) monitoring, electromyography (“EMG”), sleep analysis or polysomnography (“PSG”), intra-operative monitoring (“IOM”), and diagnostic and monitoring transcranial doppler (“TCD”) ultrasound technology.

**Newborn Care**—Includes products and services for newborn care including hearing screening, brain injury, thermoregulation, jaundice management, and various disposable newborn care supplies, as well as products for diagnostic hearing assessment for children through adult populations, and products to diagnose and assist in treating balance and mobility disorders.

#### Neurology

Our neurology business unit represents a comprehensive line of products that are used by healthcare practitioners in the diagnosis and monitoring of neurological disorders of the central and peripheral nervous system, including outpatient private practice facilities and inpatient hospital environments including diagnostic procedures and monitoring of patients during admissions, surgery, while under sedation, in post-operative care, and in intensive care units. Our neurology products and services include:

**Electroencephalography (“EEG”)**—Equipment and supplies used to monitor and visually display the electrical activity generated by the brain and other key physiological signals for both diagnosis and monitoring of neurological disorders in the hospital, research laboratory, clinician office and patient’s home.

**Electromyography (“EMG”)**—Equipment and supplies used to measure electrical activity in nerves, muscles, and critical pathways includes EMG, nerve conduction and evoked potential functionality.

**Polysomnography (“PSG”)**—Equipment and supplies used to measure a variety of respiratory and physiologic functions to assist in the diagnosis and monitoring of sleep disorders, such as insomnia and obstructive sleep apnea, a condition that causes a person to stop breathing intermittently during sleep.

**Diagnostic EEG and Long-term Monitoring**

We design, manufacture, and market a full line of instruments and supplies used to help diagnose the presence of seizure disorders and epilepsy, look for causes of confusion, evaluate head injuries, tumors, infections, degenerative diseases, and metabolic disturbances that affect the brain, and assist in surgical planning. This type of testing is also done to diagnose brain death in comatose patients. These systems and instruments work by detecting, amplifying, and recording the brain's electrical impulses (EEGs) as well as other physiological signals needed to support clinical findings. Routine clinical EEG recording is done by placing electrodes on a patient's scalp over various areas of the brain to record and detect patterns of activity and specific types of electrical

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events. EEG technologists perform the tests, and neurologists, neurophysiologists and epileptologists review and interpret the results.

Routine outpatient clinical EEG testing is performed in hospital neurology laboratories, private physician offices, and in ambulatory settings such as the patient's home, providing physicians with a clinical assessment of a patient's condition. Long-term inpatient monitoring of EEG and behavior (LTM) is used to determine complex treatment plans, and for patients with seizures that do not respond to conventional therapeutic approaches, surgical solutions may be appropriate. Patients suffering from severe head trauma and other acute conditions that may affect the brain are monitored in intensive care units ("ICUs"). In addition, research facilities use EEG equipment to conduct research on humans and laboratory animals.

Global Neuro-Diagnostic Services ("GND") which we acquired in early 2015, provides in-home ambulatory EEG monitoring. GND works with physicians and hospitals to provide superior care and testing services to its patients. Upon receiving a physician referral, GND provides program services in the patient's home, professional oversight throughout the study and preliminary report generation for physician review. GND has received accreditation by The Joint Commission as a home EEG testing services company and also has achieved the American Board of Registered Electroencephalographic and Evoked Potential Technologists (ABRET) Laboratory Accreditation in routine EEG services. GND is a leader in EEG testing services because of our focus on meeting the most stringent quality standards and providing the highest quality patient care.

### Diagnostic Electroencephalograph Monitoring Product Lines

Our EEG diagnostic monitoring product lines for neurology consist of signal amplifiers, workstations to capture and store synchronize video and EEG data, and proprietary software. These products are typically used in concert, as part of an EEG "system" by the neurology/neurophysiology department of a hospital or clinic to assist in the diagnosis and monitoring of neurological conditions.

NeuroWorks; Coherence; NicoletOne; Twin. Our EEG Systems include a broad range of products, from software licenses and ambulatory monitoring systems to advanced laboratory systems with multiple capabilities for EEG, ICU monitoring, long-term monitoring of up to 256 channels, and physician review stations with quantitative EEG analysis capabilities.

Stellate/Gotman Spike and Seizure; GridView; NicoletOne Trends. Our proprietary spike and seizure detection algorithm detects, summarizes, and reports EEG events that save health care professionals time by increasing the speed and accuracy of interpretation. GridView is a tool that allows the clinician to correlate EEG patterns with electrode contacts on a 3D view of the patient brain using magnetic resonance ("MR") or computed tomography ("CT") images, thus enabling the visualization and annotation of the brain surface and internal structures involved in the diagnosis of epilepsy. NicoletOne Trends provides a comprehensive set of EEG analysis algorithms that are used to generate compressed trends of large amounts of data to assist in the clinical evaluation and data review process.

Proprietary Signal Amplifiers. Our proprietary signal amplifiers function as the interface between the patient and the computer. The headbox connects electrodes attached to the patient's head to our EEG monitoring systems. Our proprietary amplifier products are sold for a wide variety of applications under the following brand names: Xltek, Trex, EEG32U, EMU128FS, EMU40EX, Brain Monitor, Quantum, Schwarzer EEG, Nicolet v32 and v44 models and Nicolet Wireless 32- and 64- channel amplifiers.

Nicolet Cortical Stimulator. This product is our proprietary device that provides cortical stimulation to the brain during functional brain mapping either before or during surgery to help the surgeon protect the eloquent parts of the brain. The device can be used as a standalone unit or with the fully integrated NicoletOne software that supports control of the device from the software, automated mapping and comprehensive report generation.

Global Neuro-Diagnostic Services. GND provides ambulatory EEG services with and without video in the patient's home. Other services such as Remote Monitoring, ICU monitoring, Virtual EMU monitoring and Detailed Video EEG Technical Descriptions with cloud-based test results are also provided. Our services are specifically designed to partner with hospitals and physicians to improve efficiency, results, and turn-around time, and to reduce costs.

### Electrodiagnostic Monitoring

Our electrodiagnostic systems include EMG, nerve conduction ("NCS"), and often evoked potential functionality. EMG and NCS involve the measurement of electrical activity of muscles and nerves both at rest and during contraction.

Measuring the electrical activity in muscles and nerves can help diagnose diseases of the peripheral, central nervous system or musculature system. An electromyogram is done to determine if there is any disease present that effects muscle tissue, nerves, or the junctions between nerve and muscle (neuromuscular junctions). An electromyogram can also be used to diagnose the cause of weakness, paralysis, and muscle twitching, and is also used as a primary diagnosis for carpal tunnel syndrome, which is the most frequently encountered

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peripheral compressive neuropathy. EMG is also used for clinical applications of botox to relieve muscle spasm and pain. We market both the clinical system and the needles used for these procedures.

In addition to EMG and NCS functionality, many of our Electrodiagnostic systems also include Evoked Potential functionality ("EP"). Evoked potentials are elicited in response to a stimulus. These evoked potentials can come from the sensory pathways (such as hearing and visual) or from the motor pathways. An examination tests the integrity of these pathways including the associated area of the brain. Sophisticated amplifiers are required to recognize and average evoked potential EMG and NCS signals.

### Electrodiagnostic Product Lines

**Dantec Keypoint.** The Dantec Keypoint EMG and EP family of products features amplifiers, stimulators, and strong signal quality. The Keypoint is used for advanced neurodiagnostic applications such as single fiber EMG, visual and auditory evoked potentials, and in routine nerve conduction studies. The Keypoint system is also available in a portable laptop configuration.

**Dantec Clavis.** The Dantec Clavis device is a hand-held EMG and current stimulation device that provides muscle and nerve localization information to assist with botox injections. In conjunction with the Bo-ject hypodermic needle and electrodes, physicians can better localize the site of the injection.

**Nicolet EDX family.** A hardware platform of amplifiers, base control units, stimulators and hand-held probes that are sold with Nicolet brand proprietary software. These mid to high end systems have full functionality, strong signal quality, and flexibility. They include EMG, NCS, EP's, IOM and advanced data analysis features.

**Nicolet VikingQuest.** An EMG system for the mid-range market. The device runs on our proprietary software.

**Natus Neurology UltraPro.** This is a low to mid-level product that offers high quality data collection using the Dantec Keypoint amplifiers and the proprietary Natus EMG software.

**Supplies.** We also manufacture and market a full line of proprietary EMG needles and other supplies used in the electrodiagnostic field.

### Diagnostic Polysomnography Monitoring

Polysomnography ("PSG"), which involves the analysis of respiratory patterns, brain electrical activity and other physiological data, has proven critical for the diagnosis and treatment of sleep-related diseases such as apnea, insomnia, and narcolepsy. A full polysomnographic sleep study entails a whole-night recording of brain electrical activity, muscle movement, airflow, respiratory effort, oxygen levels, electrical activity of the heart, and other parameters. In some studies patients are fitted with treatment devices using Positive Airway Pressure technology ("PAP") during the sleep study and the proper settings for the treatment devices are determined. In many cases, the sleep study is performed in the patient's home.

### Diagnostic PSG Monitoring Product Lines

We market dedicated diagnostic PSG monitoring products that can be used individually or as part of a networked system for overnight sleep studies to assist in the diagnosis of sleep disorders. Additionally we offer products that are specifically designed to be used in the patient's home. Some of our EEG systems described above can also be configured to perform diagnostic PSG monitoring. These products include software licenses, ambulatory monitoring systems, and laboratory systems that combine multiple capabilities, including EEG monitoring, physician review stations, and quantitative PSG analysis capabilities.

**Embla REMlogic, Sandman and REMbrandt; Xltek SleepWorks; Schwartz Coherence; Grass Twin and**

**NicoletOne.** Our diagnostic PSG systems capture and store all data digitally. The systems enable users to specify rules and personal preferences to be used during analysis, summarizing the results graphically and incorporating them in detailed reports.

**Proprietary Amplifiers.** Our data acquisition systems incorporate recent developments in superior amplifiers for sleep analysis and are sold under brand names such as Embla and MPR, Xltek Trex and SleepWorks, Schwarzer, and Nicolet. Our amplifiers are used in both hospitals and stand-alone clinics. In addition to exceptional signal quality, headboxes include various tools such as built-in oximeters and controls to allow the user to start and stop a study or perform electrode impedance testing either at the patient's bedside or from the monitoring room.

**Practice Management Software.** Our Embla Enterprise Practice Management Software provides a solution for institutions as well as private labs and physicians for patient scheduling, inventory control, staff scheduling, data



management, business reports and billing interfaces. Enterprise may be used in conjunction with many Natus PSG products.

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**PMSD.** PastuerMatic Sterile Dryers are used in hospital and clinic sleep laboratories to provide non-chemical sterilization of products used in sleep therapy. An environmentally friendly approach to disinfection, the PMSD products offer cost effective sterilization for sleep labs of all sizes.

**Supplies.** We also market a broad line of supplies, disposable products and accessories for the PSG laboratory.

### **Intraoperative Monitoring**

Intraoperative monitoring (“IOM”) is the use of electrophysiological methods such as EEG, EMG, and evoked potentials to monitor the functional integrity of certain neural structures (i.e. nerves, spinal cord and parts of the brain) during surgery. The purpose of IOM is to reduce the risk to the patient’s nervous system, and/or to provide functional guidance to the surgeon and anesthesiologist during surgery.

### **Diagnostic IOM Product Lines**

**Xltek Protektor.** The Protektor system is an IOM system that provides medical professionals with all information necessary to make immediate and critical surgical decisions. The system combines flexibility with multi-modality allowing full coverage of IOM techniques. The Protektor comes in 16 or 32 channel options.

**Nicolet Endeavor.** A dedicated multi-modality IOM system that offers complete flexibility in work flow and test protocols.

**Nicolet EDX.** These combo systems are used in IOM applications where a smaller number of channels is sufficient. This approach is primarily followed in international markets that utilize the integrated system approach that allows for the use of the system in EMG clinical applications as well as in IOM applications.

### **Transcranial Doppler**

Transcranial Doppler is the use of Doppler ultrasound technology to measure blood flow parameters such as velocity in key vascular structures in the brain. A Doppler probe is held against a specific location on the head and the device displays the information in both visual and auditory formats. This technology is used as preventative screening, diagnosis, and monitoring of various diseases and brain injuries such as stroke, embolism, reduced blood flow during surgery, and vasospasm.

### **Transcranial Doppler Products**

**Sonara and Sonara Tek.** The Sonara is an embedded system that is a self-contained unit that includes CPU, data display screen and speakers. It uses proprietary software with a touch screen menu. Sonara Tek is a small portable device used with a laptop. Both models enable the uploading of images to the hospital information system.

### **Newborn Care**

Our newborn care business unit represents a line of products and services that are used by healthcare practitioners in the diagnosis and treatment of common medical ailments in newborn care, as well as other products used in newborn through adult populations, including hearing diagnostics and balance & mobility systems. Our products include:

• **Newborn Hearing Screening**—Products used to screen hearing in newborns.

• **Newborn Brain Injury**—Products used to diagnose the severity of brain injury, monitor the effectiveness of drug therapies, detect seizure activity and monitor general neurological status.

• **Thermoregulation**—Products used to control the newborn environment including incubators and warmers.

• **Jaundice Management**—Products used to measure bilirubin levels and treat jaundice, the single largest cause for hospital readmission of newborns in the U.S.

• **Diagnostic Hearing Assessment**—Products used to screen for or diagnose hearing loss, or to identify abnormalities affecting the peripheral and central auditory nervous systems in patients of all ages.

• **Balance and Mobility**—Systems to diagnose and assist in treating balance disorders in an evidence-based, multidisciplinary approach.

• **NicView**—Streaming video for families with babies in the neonatal intensive care unit (NICU) that enables family members and approved friends to see the new baby, 24/7, from anywhere in the world - from any device.

### **Newborn Hearing Screening**

Hearing impairment is the most common treatable chronic disorder in newborns, affecting as many as five babies out of every 1,000 newborns. It is estimated that 20,000 hearing-impaired babies are born in the United States (“U.S.”) every year, and as many as 60,000 more in the rest of the developed world. Until the introduction of universal newborn hearing screening programs,



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screening was generally performed only on those newborns that had identifiable risk factors for hearing impairment. However, screening only those newborns with risk factors for hearing impairment overlooks approximately half of newborns with some level of hearing impairment.

Early identification of hearing impairment and early intervention has been shown to improve language development significantly. Undetected hearing impairment often results in the failure to learn, process spoken language, and speak.

### Newborn Hearing Screening Techniques

The two traditional technologies used to screen newborns and infants for hearing impairment are auditory brainstem response and otoacoustic emissions.

Auditory brainstem response (“ABR”). ABR technology is the most accurate and comprehensive method for screening and diagnosing hearing impairment. ABR technology is based on detecting the brain’s electric impulses resulting from a specific auditory stimulus.

Otoacoustic emission (“OAE”). OAEs are sounds created by the active biomechanical processes within the sensory cells of the cochlea. They occur both spontaneously and in response to acoustic stimuli. OAE screening uses a probe placed in the ear canal to deliver auditory stimuli and to measure the response of the sensory cells with a sensitive microphone.

### Newborn Hearing Screening Product Lines

Our newborn hearing screening product lines consist of the ALGO, ABAer, AuDX, and Echo-Screen newborn hearing screeners. These hearing screening products utilize proprietary signal detection technologies to provide accurate and non-invasive hearing screening for newborns and are designed to detect hearing loss at 30 or 35 dB nHL or higher.

Each of these devices is designed to generate a PASS or REFER result.

ALGO 5 and 3i Newborn Hearing Screeners. These AABR devices deliver thousands of soft audible clicks to the newborn’s ears through sound cables and disposable earphones connected to the instrument. Each click elicits an identifiable brain wave, which is detected by disposable electrodes placed on the head of the child and analyzed by the screening device. These devices use our proprietary AABR signal detection algorithm.

ABAer Newborn Hearing Screener. The ABAer, which is a PC-based newborn hearing screening device, offers a combination of AABR, OAE, and diagnostic ABR technologies in one system.

Echo-Screen. Our hand-held Echo-Screen products provide a choice or combination of proprietary ABR and OAE technologies that can also be used for children through adults. The new Echo-Screen III device is a compact, multi-modality handheld hearing screener that is tightly integrated with audible Lite Hearing Screening Data Management .

AuDX. Our AuDX product is a hand-held OAE screening device that can be used for newborn hearing screening, as well as patients of all ages, from children through adults. AuDX devices record and analyze OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient’s ear canal. OAE technology is unable to detect hearing disorders affecting the neural pathways, such as auditory neuropathy.

### Hearing Screening Supply Products

For infection control, accuracy, and ease of use, the supply products used with our newborn hearing screening devices are designed as single-use, disposable products. Each screening supply product is designed for a specific hearing screening technology.

ABR Screening Supply Kits. Each ABR screen is carried out with single-use earphones and electrodes, which are alcohol and latex-free. The adhesives used in these supply products are specially formulated for use on the sensitive skin of newborns. To meet the needs of our customers we offer a variety of packaging options. Echo-Screen and ABAer offer the choice of either an earphone or use of ear tips for perform ABR screening.

OAE Supply Products. Each OAE screen is carried out with single-use ear tips that are supplied in a variety of sizes and packaging options.

### Peloton Screening Services

Launched in early 2014, Peloton Screening Services is a nationwide service offering that provides hearing screening services to hospital-based customers. The platform of the program meets the objectives of today’s healthcare environment by aligning with family centered care principals and Joint Committee on Infant Hearing (JCIH) recommendations. Peloton provides all aspects of the program: equipment, supplies, professional oversight by nurses

or audiologists, screening personnel, case management, quality review & oversight, and state data management reporting.

Newborn Brain Injury

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For many years, newborn infants admitted to the Neonatal Intensive Care Unit (“NICU”) of a hospital have routinely been monitored for heart activity, temperature, respiration, oxygen saturation, and blood pressure. Recently it has also been considered important to monitor brain activity. A cerebral function monitor, utilizing amplitude-integrated EEGs (“aEEGs”), is a device for monitoring background neurological activity. Our simplified aEEG devices introduced over ten years ago allow neonatologists and nurses to set-up and interpret basic neurological traces without neurology oversight.

### Newborn Brain Injury Products

Our newborn brain injury products record and display parameters that the neonatologist uses to assess and monitor neurological status in the newborn. These devices continuously monitor and record brain activity, aiding in the detection and treatment of HIE and seizures. The devices also monitor the effects of drugs and other therapies on brain activity and improve the accuracy of newborn neurological assessments. They are used with electrodes attached to the head of the newborn to acquire an EEG signal that is then filtered, compressed, and displayed graphically on the device or as a hardcopy printout. The monitors have touch screens for easy navigation and onscreen keyboards for data entry at the bedside.

**Olympic Brainz Monitor.** The Olympic Brainz Monitor (“OBM”) is our latest generation Cerebral Function Monitor (“CFM”). The device can be used in single-channel, two-channel or three-channel modes to continuously monitor and record brain activity.

### Thermoregulation

Incubators offer a controlled, consistent microenvironment for thermoregulation and humidification within a closed system to maintain skin integrity and body temperature.

### Thermoregulation products

**Incubators.** Our NatalCare incubators, including those used for transporting infants, provide high thermal performance with a double wall design, easy to use control panels and features such as improved weighing functionality with automatic centering and an electronic tilting mechanism. The easy to clean, smooth design, and choice of options make these customizable incubators appropriate for different use environments.

### Jaundice Management

The American Academy of Pediatrics estimates that each year 60% of the approximately four million newborns in the U.S. become jaundiced. According to the Journal of the American Medical Association, neonatal jaundice is the single largest cause for hospital readmission of newborns in the U.S., and accounts for 50% of readmissions. Because of the serious consequences of hyperbilirubinemia, the American Academy of Pediatrics recommends that all newborns be closely monitored for jaundice and has called for the physician to determine the presence or absence of an abnormal rate of hemolysis to establish the appropriate treatment for the newborn.

In 2004, the American Academy of Pediatrics issued new guidelines for the treatment of jaundice in newborns. The guidelines recommend phototherapy as the standard of care for the treatment of hyperbilirubinemia in infants born at 35 weeks or more of gestation. The guidelines further highlight the need for “intense” phototherapy, and specifically recommend the use of the “blue” light treatment incorporated into our neoBLUE products.

### Jaundice Management Products

- **neoBLUE Product Family.** This product line consists of our neoBLUE, neoBLUE Mini, neoBLUE Cozy, and neoBLUE blanket devices, which utilize light emitting diodes (“LEDs”) to generate a high-intensity, narrow spectrum of blue light that is clinically proven to be most effective in the treatment of newborn jaundice. Our neoBLUE phototherapy devices emit significantly less ultraviolet light and heat than conventional phototherapy devices, reducing the risk of skin damage and dehydration for infants undergoing treatment. Because of the high intensity of these lights, the treatment time associated with phototherapy is reduced.
- **Medix MediLED Product Family.** A full-size, free-standing LED phototherapy system and a MediLED mini light to be used on top of an incubator or attached to the Medix radiant warmer. The MediLED incorporates an array of blue and white LEDs, while the mini system utilizes blue “super LEDs” that provide high intensity phototherapy.

### Diagnostic Hearing Assessment

We design and manufacture a variety of products used to screen for or diagnose hearing loss, or to identify abnormalities affecting the peripheral and central auditory nervous systems in patients of all ages. The technology used in most of these systems is either electrodiagnostic in nature or measures a response from the cochlea known as an OAE.

Diagnostic Hearing Assessment Product Lines

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Our diagnostic hearing assessment products consist of the Navigator Pro system, the Scout Sport portable diagnostic device, and the AuDX PRO.

**Navigator PRO.** Our Navigator PRO for hearing assessment consists of a base system that is augmented by discrete software applications that enhance the system. The Navigator Pro System is a PC-based, configurable device that utilizes evoked potentials, which are electrical signals recorded from the central nervous system that appear in response to repetitive stimuli, such as a clicking noise. The evoked potentials are used to record and display human physiological data associated with auditory and hearing-related disorders. The Navigator Pro System can be used for patients of all ages, from children to adults, including infants and geriatric patients. The device can be configured with additional proprietary software programs for various applications. These additional software programs include: MASTER, AEP, ABAer, and Scout.

**Scout SPORT.** The Scout SPORT is a PC-based OAE system. The ultra-portable Scout Sport can be carried from one computer to another to test in different locations. For office-based environments, the Scout Sport can be used with a dedicated notebook computer to create an independent portable system.

**AuDX PRO.** The AuDX PRO is a hand-held OAE screening device with a large color display that can be used for patients of all ages. The AuDX PRO records and analyzes OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient's ear canal.

### Diagnostic Hearing Supply Products

For infection control, accuracy, and ease of use, most supply products used with our diagnostic hearing devices and systems are designed as single-use, disposable products. Each screening supply product is designed for a specific diagnostic hearing technology, and is similar in nature to our previously described OAE supply products for use in newborn hearing screening.

### Balance and Mobility

Balance is an ability to maintain the line of gravity of the body within the base of support with minimal postural sway. Maintaining balance requires coordination of input from multiple sensory systems including the vestibular (i.e. inner ear), somatosensory (i.e. touch, temperature, body position), and visual systems. Balance disorders impact a large percentage of the population in all age ranges from children to adults. Common complaints include dizziness, vertigo, or an inability to walk or drive a vehicle, which can all lead to the curtailment of daily life activities. These symptoms are exacerbated in elderly patients and can result in falls, orthopedic injuries, and sometimes death.

### Balance and Mobility Products

Our principal balance and mobility products are sold under the Neurocom brand:

**EquiTest.** Proprietary protocols in the EquiTest family of devices objectively quantify and differentiate among sensory, motor, and central adaptive impairments to balance control. This approach is commonly referred to as computerized dynamic posturography ("CDP"). CDP is complementary to clinical tests designed to localize and categorize pathological mechanisms of balance disorders in that it can identify and differentiate the functional impairments associated with the identified disorders.

**Balance Master.** A family of devices providing objective assessment and retraining of the sensory and voluntary motor control of balance.

**VSR and VSR Sport.** The VSR provides objective assessment of sensory and voluntary motor control of balance with visual biofeedback. The VSR Sport is designed specifically for the athletic market as part of a concussion management program. It is portable, easy-to use and offers athletic trainers, sports medicine practitioners, and other sport professionals the data needed to make objective return-to-play decisions without relying on subjective evaluation.

**inVision.** Our inVision device incorporates a set of proprietary diagnostic tests that quantify a patient's ability to maintain visual acuity and stable gaze while actively moving the head. The objective information enables the clinician to assess the patient's ability to live and move safely in a dynamic world and to participate in daily-life functions such as driving, walking through a grocery store, or actively engaging in family activities.

### Segment and Geographic Information

We operate in one reportable segment, which we have presented as the aggregation of our neurology and newborn care product families. Within this reportable segment we are organized on the basis of the healthcare products and



services we provide which are used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, and sleep disorders.

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Our end-user customer base includes hospitals, clinics, laboratories, physicians, nurses, audiologists, and governmental agencies. Most of our international sales are to distributors, who in turn resell our products to end users or sub-distributors.

Information regarding our sales and long-lived assets in the U.S. and in countries outside the U.S. is contained in Note 17—Segment, Customer and Geographic Information of our Consolidated Financial Statements included in this report and is incorporated in this section by this reference.

#### Revenue by Product Family and Product Category

For the years ended December 31, 2015, 2014 and 2013, revenue from our product families as a percent of total revenue was approximately as follows:

|              | Year Ended December 31, |   |      |   |      |
|--------------|-------------------------|---|------|---|------|
|              | 2015                    |   | 2014 |   | 2013 |
| Neurology    | 63                      | % | 65   | % | 65   |
| Newborn Care | 37                      | % | 35   | % | 35   |
| Total        | 100                     | % | 100  | % | 100  |

We also look at revenue as either being generated from sales of Devices and Systems, which are generally non-recurring, or related Supplies and Services, which are generally recurring. The products that are attributable to these categories are described above. Revenue from Devices and Systems, Supplies and Services, as a percent of total revenue for the years ending December 31, 2015, 2014 and 2013 is as follows:

|                     | Year Ended December 31, |   |      |   |      |
|---------------------|-------------------------|---|------|---|------|
|                     | 2015                    |   | 2014 |   | 2013 |
| Devices and Systems | 64                      | % | 68   | % | 67   |
| Supplies            | 29                      | % | 30   | % | 31   |
| Services            | 7                       | % | 2    | % | 2    |
| Total               | 100                     | % | 100  | % | 100  |

In 2015, 2014 and 2013, no single end-user customer comprised more than 10% of our revenue.

#### Backlog

For the years ended December 31, 2015, 2014 and 2013, backlog was approximately as follows (in thousands):

|         | Year Ended December 31, |          |          |
|---------|-------------------------|----------|----------|
|         | 2015                    | 2014     | 2013     |
| Backlog | \$9,359                 | \$12,429 | \$12,242 |

#### Marketing and Sales

##### Marketing

Our marketing strategy differentiates our products by their level of quality, performance, and customer benefit. We educate customers worldwide about our products through:

- Trade conference exhibits; and
- Direct presentations to healthcare professionals.

##### Domestic Direct and Distributor Sales

We sell our products in North America primarily through a direct sales organization. We believe this direct sales organization allows us to maintain a higher level of customer service and satisfaction than would otherwise be possible by other distribution methods. We also sell certain products under private label and distribution arrangements.

For the years ended December 31, 2015, 2014 and 2013, domestic revenue as a percent of total revenue was approximately as follows:

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|                  | Year Ended December 31, |        |        |   |
|------------------|-------------------------|--------|--------|---|
|                  | 2015                    | 2014   | 2013   |   |
| Domestic revenue | 64.4                    | % 60.6 | % 58.0 | % |

**International Direct and Distributor Sales**

We sell some of our products outside the U.S. through direct sales channels in Canada, France, Germany, Denmark, and parts of Latin America; we sell other products in those regions and into more than 100 other countries through a distributor sales channel.

For the years ended December 31, 2015, 2014 and 2013, international revenue as a percent of total revenue was approximately as follows:

|                       | Year Ended December 31, |        |        |   |
|-----------------------|-------------------------|--------|--------|---|
|                       | 2015                    | 2014   | 2013   |   |
| International revenue | 35.6                    | % 39.4 | % 42.0 | % |

We sell products to our distributors under substantially the same terms as sales through our direct sales channels.

Terms of sales to international distributors are generally EXW, reflecting that goods are shipped "ex works," in which title and risk of loss are assumed by the distributor at the shipping point. Distributors are generally given exclusive rights in their territories to purchase products from Natus and resell to end users or sub distributors. Our distributors typically perform marketing, sales, and technical support functions in their respective markets. Each distributor may sell Natus products to their customer directly, via other distributors or resellers, or both. We actively train our distributors in product marketing, selling, and technical service techniques.

**Seasonality in Revenue**

We experience seasonality in our revenue. Demand for our products is historically higher in the second half of the year compared to the first. Our seasonality results from the purchasing habits of our hospital-based customers, whose purchases are often governed by calendar year budgets.

**Group Purchasing Organizations**

More than 90% of the hospitals in the U.S. are members of group purchasing organizations ("GPO"s), which negotiate volume purchase agreements for member hospitals, group practices, and other clinics.

For the years ended December 31, 2015, 2014 and 2013, direct purchases by GPO members as a percent of revenue were approximately as follows:

|                                 | Year Ended December 31, |       |       |   |
|---------------------------------|-------------------------|-------|-------|---|
|                                 | 2015                    | 2014  | 2013  |   |
| Direct purchases by GPO members | 9.3                     | % 9.1 | % 8.2 | % |

**Third-Party Reimbursement**

In the U.S., healthcare providers generally rely on third-party payors, including private health insurance plans, federal Medicare, state Medicaid, and managed care organizations, to reimburse all or part of the cost of the procedures they perform. Third-party payors can affect the pricing or the relative attractiveness of our products by regulating the maximum amount of reimbursement these payors provide for services utilizing our products. In addition, our Peloton hearing screening service and GND services are dependent on third-party payors to reimburse us for services provided.

**Customer Service and Support**

We generally provide a one-year warranty on our medical device products. We also sell extended service agreements on our medical device products. Service, repair, and calibration services for our domestic customers are provided by Company-owned service centers and our field service specialists. Service for international customers is provided by a combination of Company-owned facilities and vendors on a contract basis.

**Manufacturing**

Other companies manufacture a significant portion of the components used in our products; however, we perform final assembly, testing, and packaging of most of the devices ourselves to control quality and manufacturing efficiency. We also use contract vendors to manufacture some of our disposable supply and medical device products. We perform regular quality audits of these vendors.



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We purchase materials and components from qualified suppliers that are subject to our quality specifications and inspections. We conduct quality audits of our key suppliers, several of which are experienced in the supply of components to manufacturers of finished medical devices, or supplies for use with medical devices. Most of our purchased components are available from more than one supplier.

Our manufacturing, service, and repair facilities are subject to periodic inspection by local and foreign regulatory authorities. Our quality assurance system is subject to regulation by the U.S. Food and Drug Administration (“FDA”) and other government agencies. We are required to conduct our product design, testing, manufacturing, and control activities in conformance with the FDA’s quality system regulations and to maintain our documentation of these activities in a prescribed manner. In addition, our production facilities have received International Organization for Standardization (“ISO”) 13485 certification. ISO 13485 certification standards for quality operations have been developed to ensure that medical device companies meet the standards of quality on a worldwide basis. We have also received the EC Certificate pursuant to the European Union Medical Device Directive 93/42/EEC, which allows us to place a CE mark on our products.

### Research and Development

We are committed to introducing new products and supporting current product offerings in our markets through a combination of internal as well as external efforts that are consistent with our corporate strategy.

Internal product development capabilities. We believe that product development capabilities are essential to provide our customers with new product offerings. We plan to leverage our core technologies by introducing product line extensions as well as new product offerings.

Partnerships that complement our expertise. We continue to seek strategic partners in order to develop products that may not otherwise be available to us. By taking advantage of our core competencies, we believe that we can bring products to market in an efficient manner and leverage our distribution channels.

New opportunities through technology acquisition. We continue to evaluate new, emerging, and complementary technologies in order to identify new product opportunities. With our knowledge of our current markets we believe that we can effectively develop technologies into successful new products.

Our research and development expenses were \$30.4 million or 8.1% of total revenue in 2015, \$30.1 million or 8.5% of total revenue in 2014, and \$30.8 million or 8.9% of total revenue in 2013.

### Proprietary Rights

We protect our intellectual property through a combination of patent, copyright, trade secret, and trademark laws. We attempt to protect our intellectual property rights by filing patent applications for new features and products we develop. We enter into confidentiality or license agreements with our employees, consultants, and corporate partners, and seek to control access to our intellectual property, distribution channels, documentation, and other proprietary information. However, we believe that these measures afford only limited protection.

The intellectual rights to some of the original patents for technology incorporated into our products are now in the public domain. However, we do not consider these patents, or any currently viable patent or related group of patents, to be of such importance that their expiration or termination would materially affect our business.

We capitalize the cost of purchased technology and intellectual property, as well as certain costs incurred in obtaining patent rights, and amortize these costs over the estimated economic lives of the related assets.

We have several registered trademarks and service marks. Our marks are pending or registered trademarks in the United States and several foreign countries. We intend to file for additional trademarks to strengthen our trademark rights, but we cannot be certain that our trademark applications will result in registration or that our trademarks will be enforceable.

### Competition

We sell our products in competitive and rapidly evolving markets. We face competition from other companies in all of our product lines. Our competitors range from small privately-held companies to multinational corporations and their product offerings vary in scope and breadth. We do not believe that any single competitor is dominant in any of our product lines.

We derive a significant portion of our revenue from the sale of disposable supplies that are used with our medical devices. In the U.S., we sell our supply products in a mature market and we expect that our products could face

increasing competition, including competitors offering lower prices, which could have an adverse effect on our revenue and profit margins.

We believe the principal factors that will draw clinicians and other buyers to our products, include:

- Level of specificity, sensitivity, and reliability of the product;
- Time required to obtain results with the product, such as to test for or treat a clinical condition;

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Relative ease of use of the product;

Depth and breadth of the products features;

Quality of customer support for the product;

Frequency of product updates;

- Extent of third-party reimbursement of the cost of the product or procedure;

Extent to which the products conform to standard of care guidelines; and

Price of the product.

We believe that our primary competitive strength relates to the functionality and reliability of our products. Different competitors may have competitive advantages in one or more of the categories listed above and they may be able to devote greater resources to the development, promotion, and sale of their products.

### Government Regulation

#### FDA's Premarket Clearance and Approval Requirements

Unless an exemption applies, the medical devices we sell in the United States, with the exception of some disposable products, must first receive one of the following types of FDA premarket review authorizations under the Food, Drug, and Cosmetics Act, as amended:

Clearance via Section 510(k); or

- Premarket approval via Section 515 if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA's 510(k) clearance process usually takes from three to 12 months, but can take longer. The process of obtaining premarket approval via Section 515 is much more costly, lengthy, and uncertain. Premarket approval generally takes from one to three years, but can take longer. We cannot be sure that the FDA will ever grant either 510(k) clearance or premarket approval for any product we propose to market in the United States.

The FDA decides whether a device must undergo either the 510(k) clearance or premarket approval process based upon statutory criteria. These criteria include the level of risk that the FDA perceives to be associated with the device and a determination of whether the product is a type of device that is substantially equivalent to devices that are already legally marketed. The FDA places devices deemed to pose relatively less risk in either Class I or Class II, which requires the manufacturer to submit a premarket notification requesting 510(k) clearance, unless an exemption applies. The premarket notification under Section 510(k) must demonstrate that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a previously cleared 510(k) device or a device that was in commercial distribution before May 28, 1976 for which the FDA has not yet called for the submission of premarket approval applications.

The FDA places devices deemed to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed to be not substantially equivalent to a predicate device, in its Class III classification. The FDA requires these devices to undergo the premarket approval process via Section 515 in which the manufacturer must prove the safety and effectiveness of the device. A premarket approval application must provide extensive pre-clinical and clinical trial data.

The FDA may require results of clinical trials in support of a 510(k) submission and generally requires clinical trial results for a premarket approval application. In order to conduct a clinical trial on a significant-risk device, the FDA requires manufacturers to apply for and obtain, in advance, an investigational-device exemption. The investigational-device exemption application must be supported by appropriate data, such as animal and laboratory testing results. If the FDA and the Institutional Review Boards at the clinical trial sites approve the investigational-device exemption application for a significant-risk device, the manufacturer may begin the clinical trial. An investigational-device exemption approval provides for a specified clinical protocol, including the number of patients and study sites. If the manufacturer deems the product a non-significant risk device, the product will be eligible for more abbreviated investigational-device exemption requirements. If the Institutional Review Boards at the clinical trial sites concur with the non-significant risk determination, the manufacturer may begin the clinical trial. Most of our products have been cleared by the FDA as Class II devices. Some of our disposable products and newborn care products, such as our neonatal headshields and oxygen delivery systems, have received FDA clearance as Class I

devices.

#### FDA Regulation

Numerous FDA regulatory requirements apply to our products. These requirements include:

- FDA quality system regulations which require manufacturers to create, implement, and follow design, testing, control, documentation, and other quality assurance procedures;



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Medical device reporting regulations, which require that manufacturers report to the FDA certain types of adverse and other events involving their products; and

FDA general prohibitions against promoting products for unapproved uses.

Class II and III devices may also be subject to special controls applied to them, such as performance standards, post-market surveillance, patient registries, and FDA guidelines that may not apply to Class I devices. We believe we are in compliance with applicable FDA guidelines, but we could be required to change our compliance activities or be subject to other special controls if the FDA changes existing regulations or adopts new requirements.

We are subject to inspection and market surveillance by the FDA to determine compliance with regulatory requirements. If the FDA finds that we have failed to adequately comply, the FDA can institute a wide variety of enforcement actions, including:

• Issuance of a Form 483 citation;

• Fines, injunctions, and civil penalties;

• Recall or seizure of our products;

• Issuance of public notices or warnings;

• Imposition of operating restrictions, partial suspension, or total shutdown of production;

• Refusal of our requests for 510(k) clearance or pre-market approval of new products;

• Withdrawal of 510(k) clearance or pre-market approval already granted; or

• Criminal prosecution.

The FDA also has the authority to require us to repair, replace, or refund the cost of any medical device manufactured or distributed by us.

### Other Regulations

We also must comply with numerous additional federal, state, and local laws relating to matters such as safe working conditions, manufacturing practices, environmental protection, biohazards, fire hazard control, and hazardous substance disposal. We believe we are currently in compliance with such regulations.

Countries outside of the U.S. regulate medical devices in a manner similar to that of the FDA. Our manufacturing facilities are subject to audit and have been certified to be ISO 13485:2003, Medical Device Directive 93/42/EEC, and CMDCAS compliant, which allows us to sell our products in Canada, Europe, and other territories around the world. Our manufacturing facilities in North America are subject to ISO 13485 inspections by our notified body, British Standards Institution Management Systems, and by other notified bodies outside of North America. We plan to seek approval to sell our products in additional countries, while maintaining our current approvals. The time and cost of obtaining new, and maintaining existing, market authorizations from countries outside of North America, and the requirements for licensing products in these countries may differ significantly from FDA requirements.

### Employees

On December 31, 2015, we had approximately 1,067 full time employees worldwide. In Argentina, some of our production employees are represented by labor unions and our employees in Germany have established a works council. We have not experienced any work stoppages and consider our relations with our employees to be good.

### Executive Officers

The following table lists our executive officers and their ages as of February 26, 2016:

| Name                       | Age | Position(s)  |
|----------------------------|-----|--|
| James B. Hawkins           | 60  | President and Chief Executive Officer                |
| Jonathan Kennedy           | 45  | Senior Vice President and Chief Financial Officer    |
| Austin F. Noll, III        | 49  | Vice President and General Manager, Neurology SBU    |
| Kenneth M. Traverso        | 55  | Vice President and General Manager, Newborn Care SBU |
| D. Christopher Chung, M.D. | 52  | Vice President Medical Affairs, Quality & Regulatory |

James B. Hawkins has served as Chief Executive Officer, and as a member of the Board of Directors, since joining Natus in April 2004, and as President from April 2004 through January 2011 and from June 2013 to present. In addition, he currently serves as Chairman of the Board for Iradimed Corporation and serves on the Board of Directors for Eldorado Resorts, Inc. and



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OSI Systems. Prior to joining Natus, Mr. Hawkins was President, Chief Executive Officer and a Director of Invivo Corporation, a developer and manufacturer of multi-parameter vital sign monitoring equipment, and its predecessor, from August 1985 through January 2004. Mr. Hawkins also served as Secretary of Invivo from July 1986 until January 2004. He earned his undergraduate degree in Business Commerce from Santa Clara University and holds a Masters of Business Administration degree from San Francisco State University.

Jonathan A. Kennedy joined Natus as Senior Vice President and Chief Financial Officer in April 2013. Before joining Natus, Mr. Kennedy was Senior Vice President and Chief Financial Officer of Intersil Corporation, a global semiconductor manufacturer, since 2009. Prior to that, he was Intersil's Corporate Controller since 2005 and Director of Finance since 2004. Before joining Intersil, Mr. Kennedy held management roles in Finance and Information Technology with Alcon Inc. and Harris Corporation. He holds a Bachelor of Science degree in Business Administration and a Master of Science degree in Accounting from the University of Central Florida. Mr. Kennedy is also a Certified Public Accountant.

Austin F. Noll, III joined Natus in August 2012 as the Vice President and General Manager, Neurology. Mr. Noll has over 24 years' experience in the medical device industry. Mr. Noll most recently served as the President and CEO of Simpirica Spine, a California-based start-up company that developed and is commercializing a novel device for spinal stabilization, since 2009. Prior to joining Simpirica Spine, Mr. Noll was the President and CEO of NeoGuide Systems, a medical robotics company acquired by Intuitive Surgical in 2009. Prior to joining NeoGuide Systems, Mr. Noll held numerous positions at Medtronic over a 13-year period, where he served as the Vice President and General Manager of the Powered Surgical Solutions and the Neurosurgery businesses. Before Medtronic, he held sales positions at C.R. Bard and Baxter Healthcare. He received a bachelor's degree in business administration from Miami University and a master's of business administration from the University of Michigan.

Kenneth M. Traverso has served as our Vice President and General Manager, Newborn Care, since October 2012. Previously, he served as Vice President Marketing and Sales from April 2002 to September 2012. From September 2000 to April 2002, he served as our Vice President Sales. From October 1999 to July 2000, Mr. Traverso served as President of DinnerNow.com Inc., an internet aggregator for the restaurant industry. From January 1998 to September 1999, Mr. Traverso served as Vice President Sales, Western Region of Alere Medical, an outpatient chronic disease management company. From May 1995 to January 1998, Mr. Traverso served as Vice President Marketing and Sales of AbTox, Inc., a low temperature sterilization company. From August 1990 to May 1995, Mr. Traverso served in various capacities at Natus, including Vice President Sales. From September 1984 to July 1990 Mr. Traverso served various positions at Nellcor, a medical device company, including Regional Sales Manager, Western Region.

Mr. Traverso holds a Bachelor of Science degree in Administration & Marketing from San Francisco State University. D. Christopher Chung, M.D., has served as our Vice President Medical Affairs, Quality and Regulatory since June 2003, and has served as our Vice President Medical Affairs since February 2003. Dr. Chung also served as our Medical Director from October 2000 to February 2003. From August 2000 to present, Dr. Chung has also served as a Pediatric Hospitalist at the California Pacific Medical Center in San Francisco. From June 1997 to June 2000, Dr. Chung trained as a pediatric resident at Boston Children's Hospital and Harvard Medical School. From May 1986 to July 1993, Dr. Chung worked as an Engineer at Nellcor, a medical device company. Dr. Chung holds a Bachelor of Arts degree in Computer Mathematics from the University of Pennsylvania and a Doctor of Medicine degree from the Medical College of Pennsylvania-Hahnemann University School of Medicine. He is board certified in Pediatrics and is a Fellow of the American Academy of Pediatrics.

**Other Information**

Natus was incorporated in California in May 1987 and reincorporated in Delaware in August 2000.

We maintain corporate offices at 6701 Koll Center Parkway Suite 120, Pleasanton, California 94566. Our telephone number is (925) 223-6700. We maintain a corporate website at [www.natus.com](http://www.natus.com). References to our website address do not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

We make available, free of charge on our corporate website, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and all amendments to these reports, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange

Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act. We also show detail about stock trading by corporate insiders by providing access to SEC Forms 3, 4 and 5. This information may also be obtained from the SEC's on-line database, which is located at [www.sec.gov](http://www.sec.gov). Our common stock is traded on the Nasdaq Stock Market under the symbol "BABY".

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Item 1A. Risk Factors

We have completed a number of acquisitions and expect to complete additional acquisitions in the future. There are numerous risks associated with acquisitions and we may not achieve the expected benefit of any of our acquisitions. Our acquisitions of products, technology assets, or businesses may have a negative impact on our business if we fail to achieve the anticipated financial, strategic, and other benefits of acquisitions or investments, and our operating results may suffer because of this.

We expect to continue to pursue opportunities to acquire other businesses in the future. The acquisitions that we have completed may not result in improved operating results for us, or in our achieving a financial condition superior to that which we would have achieved had we not completed them. Our results of operations may be adversely impacted by costs associated with our acquisitions, including one-time charges associated with restructurings. Further, our acquisitions could fail to produce the benefits that we anticipate, or could have other adverse effects that we currently do not foresee. In addition, some of the assumptions that we have relied upon, such as achievement of operating synergies, may not be realized. In this event, one or more of the acquisitions could result in reduced earnings as compared to the earnings that would have been achieved by us if the acquisition had not occurred.

Previously we have assumed, and may in the future enter into, contingent obligations associated with earnout provisions in some of our acquisitions. We believe these provisions help us to negotiate mutually agreeable purchase terms between us and the sellers. However, a disagreement between us and a seller about the terms of an earnout provision could result in our paying more for an acquisition than we intended.

If we are required to seek additional external financing to support our need for cash to fund future acquisitions, we may not have access to financing on terms that are acceptable to us, or at all. Alternatively, we may feel compelled to access additional financing on terms that are dilutive to existing holders of our common stock or that include covenants that restrict our business, or both.

If we are not able to maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

We reported a material weakness in our internal control reporting for the year ended December 31, 2014. We remediated this material weakness in 2015 and had no material weaknesses as of December 31, 2015. A material weakness is defined under the standards issued by the Public Company Accounting Oversight Board as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected and corrected on a timely basis.

The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. In particular, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. If other material weaknesses are identified in the future or we are not able to comply with the requirements of Section 404 in a timely manner, our reported financial results could be materially misstated or could be restated, we could receive an adverse opinion regarding our controls from our accounting firm and we could be subject to investigations or sanctions by regulatory authorities, which would require additional financial and management resources, and the market price of our stock could decline. Adverse economic conditions in markets in which we operate may harm our business.

Unfavorable changes in U.S. and international economic environments may adversely affect our business and financial results. During challenging economic times, and in tight credit markets, our customers may delay or reduce capital expenditures. This could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies, and increased price competition, all of which could impact our results of operations and financial condition. In addition, we expect these factors will cause us to be more cautious in evaluating potential acquisition opportunities, which could hinder our ability to grow through acquisition while these conditions persist.

In October 2015 we announced a contract between our Argentinian subsidiary, Medix I.C.S.A, and the Ministry of Health of Venezuela under which our subsidiary would deliver products and services, including third party products,

over a three year period pursuant to prepayments received from the Venezuelan Ministry of Health. Following the announcement of this contract, there have been elections in both Venezuela and Argentina leading to significant political changes in those countries. Further, it is reported that Venezuela is experiencing a highly inflationary economy and recessionary economic conditions. These developments may impact the likelihood of the Venezuelan Ministry of Health's following through with orders under the agreement, and Medix has not yet received any prepayments under the agreement and no products or services have been

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shipped or provided. If, for these or any other reasons, the Venezuelan Ministry of Health does not make the required prepayments to initiate deliveries under the Medix agreement, we will not receive any benefit from it.

Our operating results may suffer because of our exposure to foreign currency exchange rate fluctuations

Substantially all of our sales contracts with our U.S. based customers provide for payment in U.S. dollars. With the exception of our Canadian operations, substantially all of the revenue and expenses of our foreign subsidiaries are denominated in the applicable foreign currency. To date we have executed only limited foreign currency contracts to hedge these currency risks. Our future revenue and expenses may be subject to volatility due to exchange rate fluctuations that could result in foreign exchange gains and losses associated with foreign currency transactions and the translation of assets and liabilities denominated in foreign currencies.

Substantially all our sales from our U.S. operations to our international distributors provide for payment in U.S. dollars. A strengthening of the U.S. dollar relative to other foreign currencies could increase the effective cost of our products to our international distributors as their functional currency is typically not the U.S. dollar. This could have a potential adverse effect on our ability to increase or maintain average selling prices of our products to our foreign-based customers.

We have initiated changes to our information systems that could disrupt our business and our financial results

We plan to continuously improve our information systems to support the form, functionality, and scale of our business. These types of transitions frequently prove disruptive to the underlying business of an enterprise and may cause us to incur higher costs than we anticipate. Failure to manage a smooth transition to the new systems and the ongoing operations and support of the new systems could materially harm our business operations.

For example, we've implemented the rollout of a world-wide, single-platform enterprise resource planning ("ERP") application including customer relationship management, product lifecycle management, demand management, consolidation and financial statement generation, and business intelligence. In 2012 we implemented this application in our North American operations, exclusive of the operations of Nicolet. We faced unexpected challenges in preparing our financial statements on a timely basis for the third and fourth quarters of 2012 and the first quarter of 2013 that were resolved only by devoting additional resources. In early 2014 we implemented this application in our Germany, France, and Denmark operations. In 2015, we completed the final implementation of the ERP. We may fail to gain the efficiencies the implementation is designed to produce within the anticipated timeframe. We will continue to incur additional costs associated with stabilization and ongoing development of the new platform. The ongoing development and stabilization could also be disruptive to our operations, including the ability to timely ship and track product orders to customers, project inventory requirements, manage our supply chain and otherwise adequately service our customers.

Future changes in technology or market conditions could result in adjustments to our recorded asset balance for intangible assets, including goodwill, resulting in additional charges that could significantly impact our operating results

Our balance sheet includes significant intangible assets, including goodwill and other acquired intangible assets. The determination of related estimated useful lives and whether these assets are impaired involves significant judgment.

Our ability to accurately predict future cash flows related to these intangible assets might be hindered by events over which we have no control. Due to the highly competitive nature of the medical device industry, new technologies could impair the value of our intangible assets if they create market conditions that adversely affect the competitiveness of our products. Further, declines in our market capitalization may be an indicator that our intangible assets or goodwill carrying values exceed their fair values which could lead to potential impairment charges that could impact our operating results. For example, in 2011 we recorded a \$20 million goodwill impairment charge related to our Neurology operating segment. We have also experienced impairments of our indefinite lived intangible assets during the last three years. In 2014, 2013 and 2012 we recorded charges of \$0.6 million, \$1.5 million, and \$0.6 million respectively, related to the impairment of trade names acquired from the Grass Technologies Product Group ("Grass"), Deltamed, Alpine, Schwarzer, Olympic, and Neurocom.

We may not be able to preserve the value of our intellectual property because we may not be able to protect access to it or we may lose our intellectual property rights due to expiration of our licenses or patents

If we fail to protect our intellectual property rights or if our intellectual property rights do not adequately cover the technology we employ, other medical device companies could sell products with features similar to ours, and this could reduce demand for our products. We protect our intellectual property through a combination of patent, copyright, trade secret and trademark laws. Despite our efforts to protect our proprietary rights, others may attempt to copy or otherwise improperly obtain and use our products or technology. Policing unauthorized use of our technology is difficult and expensive, and we cannot be certain that the steps we have taken will prevent misappropriation. Our means of protecting our proprietary rights may be inadequate. Enforcing our intellectual property rights could be costly and time consuming and may divert our management's attention and resources. Failing to enforce our intellectual property rights could also result in the loss of those rights.

If health care providers are not adequately reimbursed for procedures conducted with our devices or supplies, or if reimbursement policies change adversely, we may not be successful marketing and selling our products or technologies



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Clinicians, hospitals, and government agencies are unlikely to purchase our products if they are not adequately reimbursed for the procedures conducted with our devices or supplies. Unless a sufficient amount of conclusive, peer-reviewed clinical data about our products has been published, third-party payors, including insurance companies and government agencies, may refuse to provide reimbursement. Furthermore, even if reimbursement is provided, it may not be adequate to fully compensate the clinicians or hospitals. Some third-party payors may impose restrictions on the procedures for which they will provide reimbursement. If health care providers cannot obtain sufficient reimbursement from third-party payors for our products or the screenings conducted with our products, we may not achieve significant market acceptance of our products. Acceptance of our products in international markets will depend upon the availability of adequate reimbursement or funding within prevailing healthcare payment systems. Reimbursement, funding, and healthcare payment systems vary significantly by country. We may not obtain approvals for reimbursement in a timely manner or at all.

Adverse changes in reimbursement policies in general could harm our business. We are unable to predict changes in the reimbursement methods used by third-party health care payors, particularly those in countries and regions outside the U.S. For example, some payors are moving toward a managed care system in which providers contract to provide comprehensive health care for a fixed cost per person. In a managed care system, the cost of our products may not be incorporated into the overall payment for patient care or there may not be adequate reimbursement for our products separate from reimbursement for other procedures.

Our Peloton hearing screening service and our GND EEG service is dependent on third-party payors to reimburse us for services provided to patients. Adverse changes in reimbursement policies or amounts for either of these services could harm our business.

Healthcare reforms, changes in healthcare policies, and changes to third-party reimbursements for our products may affect demand for our products

In March 2010 the U. S. government signed into law the Patient Protection and Affordable Care Act and the Health Care & Education Reconciliation Act (collectively, the "ACA"). The policies supporting these laws include: basing reimbursement policies and rates on clinical outcomes; the comparative effectiveness and costs of different treatment technologies and modalities; imposing price controls; and other measures. Future significant changes in the healthcare systems in the United States or elsewhere could also have a negative impact on the demand for our current and future products. These include changes that may reduce reimbursement rates for our products and changes that may be proposed or implemented by the U.S. Presidential administration or Congress.

The ACA contains many provisions designed to generate the revenues necessary to fund the coverage expansions and to reduce costs of Medicare and Medicaid, including imposing a 2.3% excise tax on domestic sales of many medical devices by manufacturers and importers that began in 2013 which may adversely affect sales and cost of goods sold. As part of H.R. 2029 - Consolidated Appropriations Act, 2016 a moratorium was imposed on the Medical Device Excise Tax for the period beginning January 1, 2016 and ending on December 31, 2017. Unless there is further legislative action during that two-year period, the tax will be automatically reinstated for sales of medical devices on or after January 1, 2018.

In addition, other legislative changes have been proposed and adopted in the United States since the ACA was enacted. On August 2, 2011, the Budget Control Act of 2011 created, among other things, measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit reduction of at least \$1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation's automatic reduction to several government programs. This includes aggregate reductions of Medicare payments to providers up to 2% per fiscal year, which went into effect on April 1, 2013. On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012, which, among other things, further reduced Medicare payments to several providers, including hospitals and imaging centers. Such reductions may affect our current reimbursement policies for our products and services.

There are numerous steps required to implement these laws. Because of the unsettled nature of these reforms, we cannot predict what additional healthcare reforms will be implemented at the federal or state level, or the effect that any future legislation or regulation will have on our business. There is also considerable uncertainty of the impact of these reforms on the medical device market as a whole. If we fail to effectively react to the implementation of health

care reform, our business may be adversely affected.

If we fail in our efforts to educate clinicians, government agency personnel, and third-party payors about the effectiveness of our products, we may not achieve future sales growth

It is critical to the success of our sales efforts that we educate a sufficient number of clinicians, hospital administrators, and government agencies about our products and the costs and benefits of their use. The commercial success of our products depends upon clinician, government agency, and other third-party payer confidence in the economic and clinical benefits of our products as well as their comfort with the efficacy, reliability, sensitivity and specificity of our products. We believe that clinicians will not use our products unless they determine, based on published peer-reviewed journal articles and experience, that our products provide

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an accurate and cost-effective alternative to other means of testing or treatment. Our customers may choose to use competitive products, which may be less expensive or may provide faster results than our devices. Clinicians are traditionally slow to adopt new products, testing practices and clinical treatments, partly because of perceived liability risks and the uncertainty of third-party reimbursement. If clinicians, government agencies and hospital administrators do not adopt our products, we may not maintain profitability. Factors that may adversely affect the medical community's acceptance of our products include:

- Publication of clinical study results that demonstrate a lack of efficacy or cost-effectiveness of our products;

- Changing governmental and physician group guidelines;

- Actual or perceived performance, quality, price, and total cost of ownership deficiencies of our products relative to other competitive products;

- Our ability to maintain and enhance our existing relationships and to form new relationships with leading physicians, physician organizations, hospitals, state laboratory personnel, and third-party payers;

- Changes in federal, state and third-party payer reimbursement policies for our products; and

- Repeal of laws requiring universal newborn hearing screening and metabolic screening.

Sales through group purchasing organizations and sales to high volume purchasers may reduce our average selling prices, which could reduce our operating margins

We have entered, and expect in the future to enter into agreements with customers who purchase a high volume of our products. Our agreements with these customers may contain discounts from our normal selling prices and other special pricing considerations, which could cause our operating margins to decline. In addition, we have entered into agreements to sell our products to members of GPOs, which negotiate volume purchase prices for medical devices and supplies for member hospitals, group practices and other clinics. While we make sales directly to GPO members, the GPO members receive volume discounts from our normal selling price and may receive other special pricing considerations from us. Sales to members of all GPOs accounted for approximately 9.3%, 9.1% and 8.2% of our total revenue during 2015, 2014 and 2013, respectively. Certain other existing customers may be members of GPOs with which we do not have agreements. Our sales efforts through GPOs may conflict with our direct sales efforts to our existing customers. If we enter into agreements with new GPOs and some of our existing customers begin purchasing our products through those GPOs, our operating margins could decline.

Consolidation in the healthcare industry could have an adverse effect on our revenues and results of operations

Many healthcare industry companies, include our customers and competitors, are consolidating to create new companies with greater market power. As the healthcare industry consolidates, competition to provide goods and services to our customers could become more intense. Our customers may try to use their market power to negotiate price concessions and our competitors may utilize their size and broad product lines to offer cheaper alternatives to our products. If we are forced to reduce our prices because of consolidation in the healthcare industry, our revenues would decrease and our consolidated earnings, financial condition, or cash flow would suffer.

Demand for some of our products depends on the capital spending policies of our customers, and changes in these policies could harm our business

A majority of customers for our products are hospitals, physician offices, and clinics. Many factors, including public policy spending provisions, available resources, and economic cycles have a significant effect on the capital spending policies of these entities and therefore the amount that they can spend on our equipment products. If budget resources limit the capital spending of our customers, they will be unlikely to either purchase any new equipment from us or upgrade to any of our newer equipment products. Lack of liquidity in credit markets and uncertainty about future economic conditions can have an adverse effect on the spending patterns of our customers. These factors can have a significant adverse effect on the demand for our products.

Our markets are very competitive and in the United States we sell certain of our products in a mature market

We face competition from other companies in all of our product lines. Our competitors range from small privately held companies to multinational corporations and their product offerings vary in scope and breadth. We do not believe that any single competitor is dominant in any of our product lines.

The markets for certain of our products in the U.S., including the newborn hearing screening and EEG monitoring markets, are mature and we are unlikely to see significant growth for such products in the U.S. In the U.S. we derive a significant portion of our revenue from the sale of disposable supplies that are used with our hearing screening devices. Our hearing disposable supply products could face increasing competition, including competitors offering lower prices, which could have an adverse effect on our revenue and margins.

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Our competitors may have certain competitive advantages, which include the ability to devote greater resources to the development, promotion, and sale of their products. Consequently, we may need to increase our efforts, and related expenses for research and development, marketing, and selling to maintain or improve our position.

We expect recurring sales to our existing customers to generate a majority of our revenue in the future, and if our existing customers do not continue to purchase products from us, our revenue may decline.

Our operating results may decline if we do not succeed in developing, acquiring, and marketing additional products or improving our existing products

We intend to develop additional products and technologies, including enhancements of existing products, for the screening, detection, treatment, monitoring and tracking of common medical ailments. Developing new products and improving our existing products to meet the needs of current and future customers requires significant investments in research and development. If we fail to successfully sell new products, update our existing products, or timely react to changes in technology, our operating results may decline as our existing products reach the end of their commercial life cycles.

Our growth in recent years has depended substantially on the completion of acquisitions and we may not be able to complete acquisitions of this nature or of a relative size in the future to support a similar level of growth

The acquisitions that we have completed have contributed to our growth in recent years. We expend considerable effort in seeking to identify attractive acquisition candidates and ultimately, to negotiate mutually agreeable acquisition terms. If we are not successful in these efforts in the future, our growth rate will not increase at a rate corresponding to that which we have achieved in recent years. Further, as we grow larger it will be necessary to complete the acquisition of larger companies and product lines to support a growth similar to that which we have achieved in the past. The market for attractive acquisitions is competitive and others with greater financial resources than we have may be better positioned than we are to acquire desirable targets. Further, we may not be able to negotiate acquisition terms with target companies that will allow us to achieve positive financial returns from the transaction.

Our plan to expand our international operations will result in increased costs and is subject to numerous risks; if our efforts are not successful, this could harm our business

We have expanded our international operations through acquisitions and plan to expand our international sales and marketing efforts to increase sales of our products in foreign countries. We may not realize corresponding growth in revenue from growth in international unit sales, due to the lower average selling prices we receive on sales outside of the U.S. Even if we are able to successfully expand our international selling efforts, we cannot be certain that we will be able to create or increase demand for our products outside of the U.S. Our international operations are subject to other risks, which include:

- Impact of possible recessions in economies outside the U.S.;
- Political and economic instability, including instability related to war and terrorist attacks;
- Contractual provisions governed by foreign law, such as local law rights to sales commissions by terminated distributors;
- Decreased healthcare spending by foreign governments that would reduce international demand for our products;
- Continued strengthening of the U.S. dollar relative to foreign currencies that could make our products less competitive because approximately half of our international sales are denominated in U.S. dollars;
- Greater difficulty in accounts receivable collection and longer collection periods;
- Difficulties of staffing and managing foreign operations;
- Reduced protection for intellectual property rights in some countries and potentially conflicting intellectual property rights of third parties under the laws of various foreign jurisdictions;
- Difficulty in obtaining and maintaining foreign regulatory approval;
- Attitudes by clinicians, and cost reimbursement policies, towards use of disposable supplies that are potentially unfavorable to our business;
- Complying with U.S. regulations that apply to international operations, including trade laws, the U.S. Foreign Corrupt Practices Act, and anti-boycott laws, as well as international laws such as the U.K. Bribery Act;
- Loss of business through government tenders that are held annually in many cases; and

Potentially negative consequences from changes in tax laws, including legislative changes concerning taxation of income earned outside of the U.S.

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In particular, our international sales could be adversely affected by a strengthening of the U.S. dollar relative to other foreign currencies, which makes our products more costly to international customers for sales denominated in U.S. dollars.

If guidelines mandating universal newborn hearing screening do not continue to develop in foreign countries and governments do not mandate testing of all newborns as we anticipate, or if those guidelines have a long phase-in period, our sales of newborn hearing screening products may not achieve the revenue growth we have achieved in the past

We estimate that approximately 95% of the children born in the U.S. are currently being tested for hearing impairment prior to discharge from the hospital. To date, there has been only limited adoption of newborn hearing screening prior to hospital discharge by foreign governments, and when newborn hearing screening programs are enacted by foreign governments there can be a phase-in period spanning several years. The widespread adoption of guidelines depends, in part, on our ability to educate foreign government agencies, neonatologists, pediatricians, third-party payors, and hospital administrators about the benefits of universal newborn hearing screening as well as the use of our products to perform the screening and monitoring. Our revenue from our newborn hearing screening product lines may not grow if foreign governments do not require universal newborn hearing screening prior to hospital discharge, if physicians or hospitals are slow to comply with those guidelines, or if governments provide for a lengthy phase-in period for compliance.

Because we rely on distributors or sub-distributors to sell our products in most of our markets outside of the U.S., our revenue could decline if our existing distributors reduce the volume of purchases from us, or if our relationship with any of these distributors is terminated

We currently rely on our distributors or sub-distributors for a majority of our sales outside the U.S. Some distributors also assist us with regulatory approvals and education of clinicians and government agencies. Our contracts with our distributors or sub-distributors do not assure us significant minimum purchase volume. If a contract with a distributor or sub-distributor is terminated for cause or by us for convenience, the distributor or sub-distributor will have no obligation to purchase products from us. We intend to continue our efforts to increase our sales in Europe, Japan, and other developed countries. If we fail to sell our products through our international distributors, we would experience a decline in revenue unless we begin to sell our products directly in those markets. We cannot be certain that we will be able to attract new international distributors to market our products effectively or provide timely and cost-effective customer support and service. Even if we are successful in selling our products through new distributors, the rate of growth of our revenue could be harmed if our existing distributors do not continue to sell a large dollar volume of our products. None of our existing distributors are obligated to continue selling our products.

We may be subject to foreign laws governing our relationships with our international distributors. These laws may require us to make payments to our distributors if we terminate our relationship for any reason, including for cause. Some countries require termination payments under local law or legislation that may supersede our contractual relationship with the distributor. Any required payments would adversely affect our operating results.

If we lose our relationship with any supplier of key product components or our relationship with a supplier deteriorates or key components are not available in sufficient quantities, our manufacturing could be delayed and our business could suffer

We contract with third parties for the supply of some of the components used in our products and the production of our disposable products. Some of our suppliers are not obligated to continue to supply us. We have relatively few sources of supply for some of the components used in our products and in some cases we rely entirely on sole-source suppliers. In addition, the lead-time involved in the manufacturing of some of these components can be lengthy and unpredictable. If our suppliers become unwilling or unable to supply us with components meeting our requirements, it might be difficult to establish additional or replacement suppliers in a timely manner, or at all. This would cause our product sales to be disrupted and our revenue and operating results to suffer.

Replacement or alternative sources might not be readily obtainable due to regulatory requirements and other factors applicable to our manufacturing operations. Incorporation of components from a new supplier into our products may require a new or supplemental filing with applicable regulatory authorities and clearance or approval of the filing before we could resume product sales. This process may take a substantial period of time, and we may not be able to

obtain the necessary regulatory clearance or approval. This could create supply disruptions that would harm our product sales and operating results.

We depend upon key employees in a competitive market for skilled personnel, and, without additional employees, we cannot grow or maintain profitability

Our products and technologies are complex, and we depend substantially on the continued service of our senior management team. The loss of any of our key employees could adversely affect our business and slow our product development process. Our future success also will depend, in part, on the continued service of our key management personnel, software engineers, and other research and development employees, and our ability to identify, hire, and retain additional personnel, including customer service, marketing, and sales staff. Demand for these skilled employees in our industry is very competitive due to the limited number of



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people available with the necessary technical skills and understanding of our product technologies. We may be unable to attract and retain personnel necessary for the development of our business.

Our ability to market and sell products depends upon receipt of domestic and foreign regulatory approval of our products and manufacturing operations. Our failure to obtain or maintain regulatory approvals and compliance could negatively affect our business

Our products and manufacturing operations are subject to extensive regulation in the United States by the FDA and by similar regulatory agencies in other countries. Our products are classified as medical devices. Medical devices are subject to extensive regulation by the FDA pursuant to regulations that are wide ranging and govern, among other things: design and development; manufacturing and testing; labeling; storage and record keeping; advertising, promotion, marketing, sales distribution and export; and surveillance and reporting of deaths or serious injuries.

Unless an exemption applies, each medical device that we propose to market in the U.S. must first receive one of the following types of FDA premarket review authorizations:

• Clearance via Section 510(k) of the Food, Drug, and Cosmetics Act of 1938, as amended; or

• Premarket approval via Section 515 of the Food, Drug, and Cosmetics Act if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA will clear marketing of a medical device through the 510(k) process if it is demonstrated that the new product is substantially equivalent to other 510(k)-cleared products. The premarket approval application process is much more costly, lengthy and uncertain than the 510(k) process, and must be supported by extensive data from preclinical studies and human clinical trials. The FDA may not grant either 510(k) clearance or premarket approval for any product we propose to market. Further, any modification to a 510(k)-cleared device that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design or manufacture, requires a new 510(k) clearance or, possibly, approval of a premarket approval application. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review any manufacturer's decision. If the FDA requires us to seek 510(k) clearance or premarket approval for modification of a previously cleared product for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties. Further, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective.

Delays in receipt of, or failure to receive, clearances or approvals, the loss of previously received clearances or approvals, or the failure to comply with existing or future regulatory requirements could adversely impact our operating results. If the FDA finds that we have failed to comply with these requirements, the FDA can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as:

• Fines, injunctions and civil penalties;

• Recall or seizure of our products;

• Issuance of public notices or warnings;

• Imposition of operating restrictions, partial suspension, or total shutdown of production;

• Refusal of our requests for Section 510(k) clearance or premarket approval of new products;

• Withdrawal of Section 510(k) clearance or premarket approvals already granted;

• Criminal prosecution; or

Domestic regulation of our products and manufacturing operations, other than that which is administered by the FDA, includes the Environmental Protection Act, the Occupational Safety and Health Act, and state and local counterparts to these Acts.

Our business would be harmed if the FDA determines that we have failed to comply with applicable regulations governing the manufacture of our products and/or we do not pass an inspection

We and our suppliers are required to demonstrate and maintain compliance with the FDA's Quality System Regulation. The Quality System Regulation sets forth the FDA's requirements for good manufacturing practices of medical devices and includes requirements for, among other things, the design, testing, production processes, controls, quality assurance, labeling, packaging, storage and shipping of such products. In addition, we and our suppliers must engage in extensive recordkeeping and reporting and must make available our manufacturing facility and records for periodic

unscheduled inspections by federal, state and foreign agencies, including the FDA. We cannot assure you that we and our suppliers are or will continue to be in full compliance with the Quality System Regulation, and that we will not encounter any manufacturing difficulties.

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Failure of our third party suppliers and manufacturers or us to comply with applicable regulations could result in sanctions being imposed on us, including, among other things, fines, injunctions, civil penalties, failure of regulatory authorities to grant marketing approval of our products, delays, suspension or withdrawal of approvals, seizures or recalls of products and manufacturing restrictions, any of which could harm our business.

Our Olympic Cool-Cap product is subject to greater products liability exposure and FDA regulation

The FDA classifies medical devices into one of three classes depending on the degree of risk associated with each medical device and the extent of controls that are needed to ensure safety and effectiveness. Devices deemed to pose lower risk are placed in either Class I or Class II. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life supporting or implantable devices, or a device deemed to not be substantially equivalent to a previously cleared 510(k) device are placed in Class III, and generally require premarket approval from the FDA before they may be marketed.

Our Olympic Cool-Cap is a Class III minimally invasive medical device, and as such we may be subject to an increased product liability risk relative to our other Class I and Class II non-invasive products. We ceased sales of the Olympic Cool-Cap in the United States in 2013 and in Europe in 2014.

Our business may suffer if we are required to revise our labeling or promotional materials, or if the FDA takes an enforcement action against us for off-label uses

We are prohibited by the FDA from promoting or advertising our medical device products for uses not within the scope of our clearances or approvals, or from making unsupported promotional claims about the benefits of our products. If the FDA determines that our claims are outside the scope of our clearances, or are unsupported, it could require us to revise our promotional claims or take enforcement action against us. If we were subject to such an action by the FDA, our sales could be delayed, our revenue could decline, and our reputation among clinicians could be harmed. Likewise, if we acquire new products, either through the purchase of products, technology assets, or businesses, that are subsequently deemed to have inadequate supporting data, we may be required to (i) obtain adequate data, which could be costly and impede our ability to market these products, or (ii) modify the labeling on these products, which could impair their marketability, as described above.

If we deliver products with defects, we may incur costs to repair and, possibly, recall that product and market acceptance of our products may decrease.

The manufacturing and marketing of our products involve an inherent risk of our delivering a defective product or products that do not otherwise perform as we expect. We may incur substantial expense to repair any such products and may determine to recall such a product, even if not required to do so under applicable regulations. Any such recall would be time consuming and expensive. Product defects or recalls may adversely affect our customers' acceptance of the recalled and other of our products.

If we fail to comply with healthcare regulations, we could face substantial penalties and our business, operations and financial condition could be adversely affected.

We could be subject to healthcare fraud regulation and enforcement by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include: (i) the federal healthcare programs Anti-Kickback Law, which prohibits, among other things, persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual for, or the purchase, order or recommendation of, any good or service for which payment may be made under federal healthcare programs such as Medicare or Medicaid, (ii) federal false claims laws which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payors that are false or fraudulent, and which may apply to entities like us which provide coding and billing advice to customers, and/or (iii) state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers, many of which differ from their federal counterparts in significant ways, thus complicating compliance efforts.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations. Any penalties, damages, fines, curtailment or restructuring of our

operations could adversely affect our ability to operate our business and our financial results. The risk of our being found in violation of these laws is increased by the fact that their provisions are open to a variety of interpretations. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

Our operating results would suffer if we were subject to a protracted infringement claim

The medical technology industry is characterized by a substantial amount of litigation and related administrative proceedings regarding patents and intellectual property rights. We expect that medical screening and diagnostic products may become increasingly subject to third-party infringement claims as the number of competitors in our industry grows and the functionality

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of products overlap. Third parties such as individuals, educational institutions, or other medical device companies may claim that we infringe their intellectual property rights. Any claims, with or without merit, could have any of the following negative consequences:

- Result in costly litigation and damage awards;
- Divert our management's attention and resources;
- Cause product shipment delays or suspensions; or
- Require us to seek to enter into royalty or licensing agreements.

A successful claim of infringement against us could result in a substantial damage award and materially harm our financial condition. Our failure or inability to license the infringed or similar technology, or design and build non-infringing products, could prevent us from selling our products and adversely affect our business and financial results.

We may also find it necessary to bring infringement actions against third parties to seek to protect our intellectual property rights. Litigation of this nature, even if successful, is often expensive and disruptive of our management's attention, and in any event may not lead to a successful result relative to the resources dedicated to any such litigation. We license intellectual property rights from third parties and would be adversely affected if our licensors do not appropriately defend their proprietary rights or if we breach any of the agreements under which we license commercialization rights to products or technology from others.

We license rights from third parties for products and technology that are important to our business. If our licensors are unsuccessful in asserting and defending their proprietary rights, including patent rights and trade secrets, we may lose the competitive advantages we have through selling products that we license from third parties. Additionally, if it is found that our licensors infringe on the proprietary rights of others, we may be prohibited from marketing our existing products that incorporate those proprietary rights. Under our licenses, we are subject to commercialization and development, sublicensing, royalty, insurance and other obligations. If we fail to comply with any of these requirements, or otherwise breach a license agreement, the licensor may have the right to terminate the license in whole or to terminate the exclusive nature of the license.

Product liability suits against us could result in expensive and time consuming litigation, payment of substantial damages, and an increase in our insurance rates.

The sale and use of our products could lead to the filing of a product liability claim by someone claiming to have been injured using one of our products or claiming that one of our products failed to perform properly. A product liability claim could result in substantial damages and be costly and time consuming to defend, either of which could materially harm our business reputation or financial condition. Our product liability insurance may not protect our assets from the financial impact of defending a product liability claim. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing any coverage in the future.

We have experienced seasonality in the sale of our products.

We experience seasonality in our revenue. For example, our sales typically decline from the second half of our fiscal year to the first half of the fiscal year, due to patterns in the capital budgeting and purchasing cycles of our customers, many of which are government agencies, and the compensation arrangements of our direct sales employees, as those arrangements are tied to calendar-year sales plans. We anticipate that we will continue to experience seasonal fluctuations, which may lead to fluctuations in our quarterly operating results. We believe that you should not rely on our results of operations for interim periods as an indication of our expected results in any future period.

An interruption in or breach of security of our information or manufacturing systems, including the occurrence of a cyber-incident or a deficiency in our cybersecurity, or disclosure of private patient health information, may result in a loss of business or damage to our reputation.

We rely on communications, information and manufacturing systems to conduct our business. Any failure, interruption or cyber incident of these systems could result in failures or disruptions in our customer relationship management or product manufacturing. A cyber incident is an intentional attack or an unintentional event that can include gaining unauthorized access to information systems to disrupt operations, corrupt data, or steal confidential information. The occurrence of any failures, interruptions or cyber incidents could result in a loss of customer

business or reputation and have a material effect on our business, financial condition, results of operations and cash flows.

In the course of performing our business we obtain, from time to time, confidential patient health information. For example, we may learn patient names and be exposed to confidential patient health information when we provide training on our products to our customers' staff. Complying with federal and state privacy and security requirements imposes compliance related costs, subjects us to potential regulatory audits, and may restrict our business operations. These various laws may be

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subject to varying interpretations by courts and government agencies creating potentially complex compliance issues for our business. If we were to violate any of our legal obligations to safeguard any confidential patient health information or protected health information against improper use and disclosure, we could lose customers and be exposed to liability, and our reputation and business could be harmed. Concerns or allegations about our practices with regard to the privacy or security of personal health information or other privacy-related matters, even if unfounded, could damage our reputation and harm our business.

We are also subject to laws and regulations in foreign countries covering data privacy and other protection of health and employee information that may be more onerous than corresponding U.S. laws. These regulations may require that we obtain individual consent before we collect or process any personal data, restrict our use or transfer of personal data, impose technical and organizational measures to ensure the security of personal data, and require that we notify regulatory agencies, individuals or the public about any data security breaches. As we expand our international operations, we may be required to expend significant time and resources to put in place additional mechanisms to ensure compliance with multiple data privacy laws. Failure to comply with these laws may result in significant fines and other administrative penalties and harm our business.

Our stock price may be volatile, which may cause the value of our stock to decline or subject us to a securities class action litigation.

The trading price of our common stock price may be volatile and could be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including:

- general economic, industry and market conditions;
- actions by institutional or other large stockholders;
- the depth and liquidity of the market for our common stock;
- volume and timing of orders for our products;
- developments generally affecting medical device companies;
- the announcement of new products or product enhancements by us or our competitors;
- changes in earnings estimates or recommendations by securities analysts;
- investor perceptions of us and our business, including changes in market valuations of medical device companies; and
- our results of operations and financial performance.

In addition, the stock market in general, and the NASDAQ Stock Market and the market for medical devices in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating performance of particular companies. These broad market fluctuations may cause the trading price of our common stock to decline. In the past, securities class action litigation has often been brought against a company after a period of volatility in the market price of its common stock. We may become involved in this type of litigation in the future. Any securities litigation claims brought against us could result in substantial expense and the diversion of management's attention from our business.

### ITEM 1B. Unresolved Staff Comments.

None.

### ITEM 2. Properties

Our corporate headquarters are located in Pleasanton, California, in a facility covering 8,200 square feet pursuant to a lease that expires in October 2019.

We also utilize the following properties:

#### Company-owned Facilities:

- 16,000 square feet in Buenos Aires, Argentina, utilized substantially for manufacturing;
- 44,900 square feet in Oakville, Ontario, Canada, utilized substantially for research and development;
- 26,600 square feet in Gort, Ireland, utilized substantially for manufacturing;
- 26,000 square feet in Mundelein, Illinois, previously utilized substantially for manufacturing. Currently held for sale; and
- 6,400 square feet in Old Woking, England, utilized substantially for research and development.

#### Leased Facilities:

Following is a listing of our most significant leased properties; we have a number of smaller facilities under lease in various countries where we operate.

124,000 square feet in Middleton, Wisconsin, pursuant to a lease that expires in April 2024, that is primarily utilized for manufacturing;



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• 65,000 square feet in Seattle, Washington, pursuant to a lease that expires in December 2017, that is utilized substantially for manufacturing;

• 43,000 square feet in Planegg, Germany, pursuant to a lease that expires in December 2021 that is utilized substantially for manufacturing; and

• 14,300 square feet in Skovlunde, Denmark, pursuant to a lease that expires with six-month notice that is utilized for research and development.

ITEM 3. Legal Proceedings

We may from time to time become a party to various legal proceedings or claims that arise in the ordinary course of business. We are not currently involved in any legal or administrative proceedings that we believe are likely to have a material effect on our business, financial condition, or results of operations, although we cannot be assured of the outcome of such matters.

ITEM 4. Mine Safety Disclosures

The disclosure required by this item is not applicable.

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## PART II

## ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on the Nasdaq Global Select Market under the symbol "BABY". The following table sets forth, for the periods indicated, the high and low sale price per share of our common stock, as reported on the Nasdaq Global Select Market.

|                                      | High    | Low     |
|--------------------------------------|---------|---------|
| Fiscal Year Ended December 31, 2015: |         |         |
| Fourth Quarter                       | \$51.05 | \$37.85 |
| Third Quarter                        | 46.98   | 29.34   |
| Second Quarter                       | 44.37   | 35.73   |
| First Quarter                        | 40.05   | 33.85   |
| Fiscal Year Ended December 31, 2014: |         |         |
| Fourth Quarter                       | \$36.98 | \$28.34 |
| Third Quarter                        | 29.90   | 24.03   |
| Second Quarter                       | 26.95   | 21.54   |
| First Quarter                        | 27.71   | 21.11   |

As of February 22, 2016, there were 33,155,154 shares of our common stock issued and outstanding and held by approximately 28 stockholders of record. We estimate that there are approximately 22,048 beneficial owners of our common stock.

## Dividends

We have never declared or paid cash dividends on our capital stock. We currently expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future.

## Stock Performance Graph

The following information of Part II Item 5 is being furnished and shall not be deemed to be "soliciting material" or to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section, nor will it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate such information by reference thereto.

The following graph shows a comparison, from January 1, 2010 through December 31, 2015, of cumulative total return for our common stock, the Nasdaq Composite Index and the Standard & Poor's 500 Health Care Equipment Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Standard & Poor's 500 Health Care Equipment Index assumes reinvestment of dividends.

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|                                     |          |        |          |        |        |        |        |
|-------------------------------------|----------|--------|----------|--------|--------|--------|--------|
|                                     |          | 2010   | 2011     | 2012   | 2013   | 2014   | 2015   |
| Natus Medical Inc.                  | Return % |        | (33.50 ) | 18.35  | 101.61 | 60.18  | 33.32  |
|                                     | Cum \$   | 100.00 | 66.50    | 78.70  | 158.67 | 254.16 | 338.85 |
| NASDAQ Composite-Total Returns      | Return % |        | (0.83 )  | 17.45  | 40.12  | 14.75  | 6.96   |
|                                     | Cum \$   | 100.00 | 99.17    | 116.48 | 163.21 | 187.28 | 200.31 |
| S&P 500 Health Care Equipment Index | Return % |        | (0.80 )  | 17.27  | 27.69  | 26.28  | 5.97   |
|                                     | Cum \$   | 100.00 | 99.20    | 116.33 | 148.54 | 187.58 | 198.78 |

## Purchases of Equity Securities by the Issuer

The following table provides information regarding repurchases of common stock for the three months ended December 31, 2015.

| Period                             | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|------------------------------------|----------------------------------|------------------------------|--|--|
| October 1, 2015—October 31, 2015   | 18,000                           | \$40.80                      | 252,229  | \$ 15,294,982  |
| November 1, 2015—November 30, 2015 | 5,965                            | \$46.45                      | 258,194  | \$ 15,017,908  |
| December 1, 2015—December 31, 2015 | 23,721                           | \$48.91                      | 281,915  | \$ 13,857,714  |
| Total                              | 47,686                           | \$45.54                      | 281,915  | \$ 13,857,714  |

In June 2014, the Board of Directors authorized the repurchase of up to \$10 million of common stock pursuant to a stock repurchase program. In June 2015 the program was expanded to include up to an additional \$20 million of our common stock. There is no set expiration date for the program.

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## ITEM 6. Selected Financial Data

The following tables set forth certain selected consolidated financial data for each of the years in the five-year period ended December 31, 2015, and is derived from the Consolidated Financial Statements of Natus Medical Incorporated and its subsidiaries. The Consolidated Financial Statements for each of the years in the three-year period ended December 31, 2015 are included elsewhere in this report. The selected consolidated balance sheet data as of December 31, 2013, 2012 and 2011 and the consolidated statements of operations data for the years ended December 31, 2012 and 2011 are derived from our Consolidated Financial Statements, which are not included in this report. The selected consolidated financial data set forth below is qualified in its entirety by, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included elsewhere in this report.

|   | Year ended December 31,               |           |           |           |             |
|---|---------------------------------------|-----------|-----------|-----------|-------------|
|   | 2015                                  | 2014      | 2013      | 2012      | 2011        |
|   | (in thousands, except per share data) |           |           |           |             |
| Consolidated Statement of Operations Data (a) (c):                            |                                       |           |           |           |             |
| Revenue   | \$375,865                             | \$355,834 | \$344,112 | \$292,280 | \$232,895   |
| Cost of revenue   | 145,492                               | 138,480   | 138,788   | 126,430   | 99,447      |
| Intangibles amortization  | 2,836                                 | 2,967     | 2,912     | 2,524     | 2,163       |
| Gross profit  | 227,537                               | 214,387   | 202,412   | 163,326   | 131,285     |
| Operating expenses:   |                                       |           |           |           |             |
| Marketing and selling   | 87,675                                | 85,729    | 83,138    | 73,970    | 61,410      |
| Research and development  | 30,434                                | 30,100    | 30,786    | 28,616    | 24,256      |
| General and administrative  | 46,363                                | 45,444    | 43,380    | 40,568    | 30,204      |
| Intangibles amortization  | 7,447                                 | 3,025     | 5,681     | 6,246     | 2,962       |
| Restructuring   | 2,145                                 | 4,238     | 4,767     | 8,814     | 2,786       |
| Goodwill impairment charge (b)  | —                                     | —         | —         | —         | 20,000      |
| Total operating expense   | 174,064                               | 168,536   | 167,752   | 158,214   | 141,618     |
| Income (loss) from operations   | 53,473                                | 45,851    | 34,660    | 5,112     | (10,333 )   |
| Other income (expense), net   | (1,064 )                              | 158       | (2,716 )  | (835 )    | (74 )       |
| Income (loss) before provision for income tax                                 | 52,409                                | 46,009    | 31,944    | 4,277     | (10,407 )   |
| Provision for income tax  | 14,485                                | 13,531    | 8,797     | 454       | 772         |
| Net income (loss)   | \$37,924                              | \$32,478  | \$23,147  | \$3,823   | \$(11,179 ) |
| Earnings (loss) per share:  |                                       |           |           |           |             |
| Basic   | \$1.17                                | \$1.03    | \$0.77    | \$0.13    | \$(0.39 )   |
| Diluted   | \$1.14                                | \$1.00    | \$0.75    | \$0.13    | \$(0.39 )   |
| Weighted average shares used in the calculation of earnings (loss) per share: |                                       |           |           |           |             |
| Basic   | 32,348                                | 31,499    | 29,993    | 29,031    | 28,565      |
| Diluted   | 33,241                                | 32,568    | 30,821    | 29,837    | 28,565      |
|   | December 31,                          |           |           |           |             |
|   | 2015                                  | 2014      | 2013      | 2012      | 2011        |
|   | (in thousands)                        |           |           |           |             |
| Consolidated Balance Sheet Data:  |                                       |           |           |           |             |
| Cash, cash equivalents, and short-term investments                            | \$82,469                              | \$66,558  | \$56,106  | \$23,057  | \$32,816    |
| Working capital   | 164,248                               | 148,665   | 118,585   | 71,893    | 89,497      |
| Total assets  | 479,496                               | 434,821   | 429,457   | 394,492   | 314,846     |
| Long-term debt (including current portion) and short-term borrowings          | —                                     | —         | 38,017    | 32,860    | 898         |

|                            |         |         |         |         |         |
|----------------------------|---------|---------|---------|---------|---------|
| Total stockholders' equity | 390,710 | 352,715 | 308,214 | 270,380 | 258,313 |
|----------------------------|---------|---------|---------|---------|---------|

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Results of operations and financial position of the businesses we have acquired are included from their acquisition (a) dates as follows: Embla in September 2011, Nicolet in July 2012, Grass in February 2013, Peloton in January 2014, GND and NicView in January 2015, and Monarch in November 2015.

(b) The \$20.0 million goodwill impairment charge in 2011 is related to our Neurology operating segment.

Data for 2014, 2013, 2012 and 2011 reflects reclassifications from Cost of revenue to Intangibles amortization, (c) from Marketing and selling, Research and development, and General and administrative to Intangible amortization, and from General and administrative to Restructuring.

### ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our Consolidated Financial Statements and the accompanying footnotes. MD&A includes the following sections:

#### Business

Natus is a leading provider of healthcare products and services used in the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders.

We have completed a number of acquisitions since 2003, consisting of either the purchase of a company, substantially all of the assets of a company, or individual products or product lines. In 2015 we completed three acquisitions, NicView, GND, and Monarch Medical Diagnostics, LLC ("Monarch"). We expect to continue to pursue opportunities to acquire other businesses in the future.

#### Year 2015 Overview

In 2015, we completed acquisitions of one business in the newborn care market and of two businesses in the neurology diagnostic services market for total cash consideration of \$15.2 million. These acquisitions allowed us to offer patients a more convenient way to complete routine EEG testing and provide families with streaming video of their babies in the neonatal intensive care unit.

Our consolidated revenue increased by \$20.0 million for the year ended December 31, 2015 compared to 2014. This increase was driven by recent acquisitions and organic growth in our Newborn Care business.

Net income was \$37.9 million, or \$1.14 per diluted share in the year ended December 31, 2015, compared with net income of \$32.5 million, or \$1.00 per diluted share in 2014. This increase in income was primarily the result of increased revenue and gross profit. We incurred \$2.1 million of restructuring charges in 2015 as we took additional steps to improve efficiencies in operations and eliminate redundant costs from acquisitions.

#### Application of Critical Accounting Policies

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In so doing, we must often make estimates and use assumptions that can be subjective and, consequently, our actual results could differ from those estimates. For any given individual estimate or assumption we make, there may also be other estimates or assumptions that are reasonable.

We believe that the following critical accounting policies require the use of significant estimates, assumptions, and judgments. The use of different estimates, assumptions, and judgments could have a material effect on the reported amounts of assets, liabilities, revenue, expenses, and related disclosures as of the date of the financial statements and during the reporting period.

#### Revenue recognition

Revenue, net of discounts, is recognized from sales of medical devices and supplies, including sales to distributors, when the following conditions have been met: a purchase order has been received, title has transferred, the selling price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Terms of sale for most domestic sales are FOB origin, reflecting that title and risk of loss are assumed by the purchaser at the shipping point; however, terms of sale for some neurology, sleep-diagnostic, and head cooling systems are FOB destination, reflecting that title and risk of loss are assumed by the purchaser upon delivery. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped "ex works," in which title and risk of loss are assumed by the distributor at the shipping point. For products shipped under FOB origin



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or EXW terms, delivery is generally considered to have occurred when the product is shipped. Freight charges billed to customers are included in revenue and freight-related expenses are charged to cost of revenue. We generally do not provide rights of return on products.

For products containing embedded software, we have determined that the hardware and software components function together to deliver the products' essential functionality, and therefore, the revenue from the sale of these products does not fall within the scope of the software revenue recognition rules. Our revenue recognition policies for sales of these products are substantially the same as for our other tangible products.

Revenue from sales of certain of our products that remain within the scope of the software revenue recognition rules under ASC Subtopic 985-605 is not significant.

Revenue from extended service and maintenance agreements, for both medical devices and data management systems, is recognized ratably over the service period. Revenue from installation or training services is deferred until such time service is provided.

Certain revenue transactions include multiple element arrangements. We allocate revenue in these arrangements to each unit of accounting using the relative selling price method. The selling prices used during the allocation process are based on vendor specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE or TPE is available.

Group purchasing organizations ("GPOs") negotiate volume purchase prices for member hospitals, group practices, and other clinics. Our agreements with GPOs typically contain preferential terms for the GPO and its members, including provisions for some, if not all, of the following:

- Payment of marketing fees by Natus to the GPO, usually based on purchasing experience of group members; and
- Non-recourse cancellation provisions.

We do not sell products to GPOs. Hospitals, group practices, and other clinics that are members of a GPO purchase products directly from us under the terms negotiated by the GPO. Negotiated pricing and discounts are recognized as a reduction of the selling price of products at the time of the sale. Revenue from sales to members of GPOs is otherwise consistent with general revenue recognition policies as previously described.

### Inventory

Inventories are carried at the lower of cost or market, with cost being determined using the first-in, first-out method. The carrying value of our inventories is reduced for any difference between cost and estimated market value of inventories that is determined to be obsolete or unmarketable, based upon assumptions about future demand and market conditions. Adjustments to the value of our inventory establish a new cost basis and are considered permanent even if circumstances later suggest that increased carrying amounts are recoverable. If demand is higher than expected, we may sell inventory that had previously been written down.

### Carrying value of intangible assets and goodwill

We amortize intangible assets with finite lives over their useful lives; any future changes that would limit their useful lives or any determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges.

During the second quarter of 2015 we initiated a strategy to increase the brand strength of Natus by replacing acquired product trade names with Natus branded products over time. The implementation of this strategy places definite expected future lives on our acquired trade names which previously had indefinite lives. We assigned these trade names lives of seven years based on the timeline of our branding strategy. We will continue to assess the lives of these assets based on the timing and execution of this strategy. Amortization expense for trade names is recorded as a component of operating expense.

Goodwill is not amortized but is subject to an annual impairment analysis, which is performed as of October 1st; this assessment is also performed whenever there is a change in circumstances that indicates the carrying value of these assets may be impaired.

In 2015 and 2014, we performed qualitative assessments to test our reporting units' goodwill for impairment.

Qualitative factors considered in this assessment include industry and market considerations, overall financial performance and other relevant events and factors affecting each reporting unit. Based on our qualitative assessment, we determined that the fair value of each reporting unit was more likely than not to be greater than its carrying



amount, and no impairment was recognized.

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In 2013, we performed a two-step impairment test on our goodwill. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit to its carrying value, including goodwill. We use a projected discounted cash flow model to determine the fair value of a reporting unit. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and the second step of the impairment test is not required. The second step, if required, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. The fair value of a reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. If the carrying amount of the reporting unit's goodwill exceeds its implied fair value, an impairment charge is recognized in an amount equal to that excess.

Goodwill impairment analysis and measurement is a process that requires significant judgment. Future changes in the judgments and estimates underlying our analysis of goodwill for possible impairment, including expected future cash flows and discount rate, could result in a significantly different estimate of the fair value of the reporting units and could result in additional impairment of goodwill.

### Long lived assets

We continually monitor events and changes in circumstances that could indicate that carrying amounts of its long-lived assets, including property and equipment and intangible assets that may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability by determining whether the carrying value of such assets or asset groups will be recovered through their undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we will recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

### Liability for product warranties

We provide a warranty with our products that is generally one year in length and in some cases, regulations may require us to provide repair or remediation beyond our typical warranty period. If any of our products contain defects, we may be required to incur additional repair and remediation costs. Service for domestic customers is provided by Company-owned service centers that perform all service, repair, and calibration services. Service for international customers is provided by a combination of Company-owned facilities and vendors on a contract basis.

A warranty reserve is included in accrued liabilities for the expected future costs of servicing products. Additions to the reserve are based on management's best estimate of probable liability. We consider a combination of factors including material and labor costs, regulatory requirements, and other judgments in determining the amount of the reserve. The reserve is reduced as costs are incurred to honor existing warranty and regulatory obligations.

### Share-based compensation

We recognize share-based compensation expense associated with employee stock options under the single-option straight line method over the requisite service period, which is generally a four-year vesting period pursuant to ASC Topic 718, Compensation-Stock Compensation. See Note 12 of our Consolidated Financial Statements.

For employee stock options, the value of each option is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of freely traded options. Similar to other option pricing models, the Black-Scholes method requires the input of highly subjective assumptions, including stock price volatility. Changes in the subjective input assumptions can materially affect the estimated fair value of our employee stock options.

We recognize share-based compensation associated with Restricted Stock Awards ("RSA") and Restricted Stock Units ("RSU"). RSAs and RSUs vest ratably over a three-year period for employees. RSAs and RSUs for executives vest over a four-year period; 50% on the second anniversary of the vesting start date and 25% on each of the third and fourth anniversaries of the vesting date. The value is estimated based on the market value of our stock on the date of issuance pursuant to ASC Topic 718, Compensation-Stock Compensation.

We issue new shares of common stock upon the exercise of stock options and the vesting of RSAs and RSUs. Forfeitures of employee stock options and awards are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Share-based compensation expense is recorded net of estimated forfeitures, such that expense is recorded only for those share-based awards that are expected to vest.

The cash flow from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for employee options (excess tax benefits) is classified as a cash inflow from financing activities and a cash outflow from operating activities

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in our Statements of Cash Flows. We treat tax deductions from certain stock option exercises as being realized when they reduce taxes payable in accordance with relevant tax law.

## Results of Operations

The following table sets forth for the periods indicated selected consolidated statement of income data as a percentage of total revenue. Our historical operating results are not necessarily indicative of the results for any future period.

|  | Percent of Revenue       |    |       |   |       |    |
|--|--------------------------|----|-------|---|-------|----|
|  | Years Ended December 31, |    |       |   |       |    |
|  | 2015                     |    | 2014  |   | 2013  |    |
| Revenue                                | 100.0                    | %  | 100.0 | % | 100.0 | %  |
| Cost of revenue                        | 38.7                     | %  | 38.9  | % | 40.3  | %  |
| Intangibles amortization               | 0.8                      | %  | 0.8   | % | 0.8   | %  |
| Gross profit                           | 60.5                     | %  | 60.2  | % | 58.8  | %  |
| Operating expenses:                    |                          |    |       |   |       |    |
| Marketing and selling                  | 23.3                     | %  | 24.1  | % | 24.2  | %  |
| Research and development               | 8.1                      | %  | 8.5   | % | 8.9   | %  |
| General and administrative             | 12.3                     | %  | 12.8  | % | 12.6  | %  |
| Intangibles amortization               | 2.0                      | %  | 0.9   | % | 1.7   | %  |
| Restructuring                          | 0.6                      | %  | 1.2   | % | 1.4   | %  |
| Total operating expenses               | 46.3                     | %  | 47.4  | % | 48.7  | %  |
| Income from operations                 | 14.2                     | %  | 12.9  | % | 10.1  | %  |
| Other income (expense), net            | (0.3)                    | )% | —     | % | (0.8) | )% |
| Income before provision for income tax | 13.9                     | %  | 12.9  | % | 9.3   | %  |
| Provision for income tax expense       | 3.9                      | %  | 3.8   | % | 2.6   | %  |
| Net income                             | 10.1                     | %  | 9.1   | % | 6.7   | %  |

## Comparison of 2015 and 2014

|                            | Year ended December 31, |           |        |    |
|----------------------------|-------------------------|-----------|--------|----|
|                            | 2015                    | 2014      | Change |    |
| Neurology                  |                         |           |        |    |
| Devices and Systems        | \$168,776               | \$173,006 | (2     | )% |
| Supplies                   | 60,205                  | 59,666    | 1      | %  |
| Services                   | 8,320                   | —         | 100    | %  |
| Total Neurology Revenue    | 237,301                 | 232,672   | 2      | %  |
| Newborn Care               |                         |           |        |    |
| Devices and Systems        | 72,669                  | 67,354    | 8      | %  |
| Supplies                   | 49,982                  | 48,697    | 3      | %  |
| Services                   | 15,913                  | 7,111     | 124    | %  |
| Total Newborn Care Revenue | 138,564                 | 123,162   | 13     | %  |
| Total Revenue              | \$375,865               | \$355,834 | 6      | %  |

For the year ended December 31, 2015, Neurology revenue increased by 2% compared to the prior year with the growth coming primarily from GND services provided in the domestic market. Devices and Systems revenue declined by 2% for the year ended December 31, 2015 compared to the prior year due mainly to a strong US Dollar as compared to the Euro and Canadian Dollar in 2015. Supplies revenue for the twelve-month period increased 1% compared to the prior year due mainly to strong sales

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in our domestic market. Services revenue in 2015 is the result of our entry into the ambulatory EEG service market through the acquisition of GND in January 2015.

For the year ended December 31, 2015, Newborn Care revenue increased by 13% compared to the prior year with growth in both international and domestic markets. Devices and Systems revenue increased by 8% compared to the prior year due mainly to the acquisition of NicView, our video streaming initiative, Balance Monitoring and Distributed products. Supplies revenue for the twelve-month period increased 3% compared to the prior year. Services revenue increased by 124% compared to the prior year due mainly to the growth in Peloton and our Neometrics Data Management services.

No single customer accounted for more than 10% of our revenue in either 2015 or 2014. Revenue from domestic sales increased 12% to \$242.1 million in 2015, from \$215.5 million in 2014 primarily due to an increase in our services business and continued strong demand for our devices and systems in the U.S. Revenue from international sales decreased 5% in 2015 to \$133.8 million from \$140.3 million in 2014 primarily due to stronger dollar against the Euro and Canadian dollars. Revenue from domestic sales was 64% of total revenue in 2015 compared to 61% of total revenue in 2014, and revenue from international sales was 36% of total revenue in 2015 compared to 39% of total revenue in 2014.

**Cost of Revenue and Gross Profit**

|                          | Year ended December 31, |           |   |
|--------------------------|-------------------------|-----------|---|
|                          | 2015                    | 2014      |   |
| Revenue                  | \$375,865               | \$355,834 |   |
| Cost of revenue          | 145,492                 | 138,480   |   |
| Intangibles amortization | 2,836                   | 2,967     |   |
| Gross profit             | 227,537                 | 214,387   |   |
| Gross profit percentage  | 60.5                    | % 60.2    | % |

For the year ended December 31, 2015, our gross profit as a percentage of sales increased by 0.3% compared to the prior year. This increase in gross profit was driven by higher domestic revenues which generally have higher gross margins than international sales, as well as cost reduction initiatives which resulted in higher margins primarily in Neurology devices. These increases in gross profit were largely offset by a \$6.6 million charge recorded to accrue for the estimated costs of bringing certain NeoBLUE® phototherapy products into U.S. regulatory compliance.

**Operating Costs**

|                            | Year ended December 31, |          |   |
|----------------------------|-------------------------|----------|---|
|                            | 2015                    | 2014     |   |
| Marketing and selling      | \$87,675                | \$85,729 |   |
| Percentage of revenue      | 23.3                    | % 24.1   | % |
| Research and development   | \$30,434                | \$30,100 |   |
| Percentage of revenue      | 8.1                     | % 8.5    | % |
| General and administrative | \$46,363                | \$45,444 |   |
| Percentage of revenue      | 12.3                    | % 12.8   | % |
| Intangibles Amortization   | \$7,447                 | \$3,025  |   |
| Percentage of revenue      | 2.0                     | % 0.9    | % |
| Restructuring              | \$2,145                 | \$4,238  |   |
| Percentage of revenue      | 0.6                     | % 1.2    | % |

Marketing and selling expenses as a percentage of revenue decreased in 2015 compared to 2014. The slight increase in expense is related to the addition of expenses following the GND and NicView acquisitions in 2015.

**Research and Development**

Research and development expenses increased slightly during the year ended December, 31, 2015 compared to the prior year. This is primarily driven by activities related to the remediation of certain deficiencies identified in our quality system.



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## General and Administrative

General and administrative expenses has increased during the year ended December 31, 2015 compared to the prior year. The increase in expenses is related to an increase of \$0.6 million in Peloton employee expenses and the addition of expenses following the GND acquisition of \$0.5 million.

## Intangibles Amortization

Intangibles amortization increased in 2015 compared to 2014. During the second quarter of 2015 we initiated a strategy to increase the brand strength of Natus by replacing acquired product trade names with Natus branded products over time. The implementation of this strategy places definite expected future lives on our acquired trade names which previously had indefinite lives. We assigned these trade names lives of seven years based on the time line of our branding strategy.

## Restructuring

Restructuring costs decreased during the year ended December 31, 2015 compared to the prior year. In 2014 we experienced higher expenses related to facilities consolidation. During the third quarter of 2014 we listed our manufacturing facility in Mundelein, Illinois for sale and recorded a disposal expense of \$2.2 million to reflect the difference between net realizable value and book value.

## Other Income (Expense), net

Other income (expense), net consists of interest income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income (expense), net of \$(1.0) million in 2015, compared to \$158,000 in 2014. Interest income of \$27,000 in 2015 was \$92,000 less than the amount reported for 2014. We reported \$1.4 million of foreign currency exchange losses in 2015 versus \$37,000 of foreign exchange losses in 2014. This increase was driven primarily by the declining value of foreign currencies in which we transact. Interest expense was \$352,000 in 2015 compared to \$438,000 in 2014.

## Provision for Income Tax

The actual effective tax rate ("ETR") for 2015 is 27.6% as compared to 29.4% for 2014. The lower effective tax rate in 2015 compared with 2014 is primarily due to a change in geographic mix of income offset by the release of a deferred tax asset valuation allowance in 2014 and an increase in state taxes.

## Comparison of 2014 and 2013

## Revenue

|                            | Year ended December 31, |            |        |    |
|----------------------------|-------------------------|------------|--------|----|
|                            | 2014                    | 2013       | Change |    |
| Neurology                  |                         |            |        |    |
| Devices and Systems        | \$ 173,006              | \$ 162,607 | 6      | %  |
| Supplies                   | 59,666                  | 61,065     | (2)    | )% |
| Services                   | —                       | —          | —      | %  |
| Total Neurology Revenue    | 232,672                 | 223,672    | 4      | %  |
| Newborn Care               |                         |            |        |    |
| Devices and Systems        | 67,354                  | 68,588     | (2)    | )% |
| Supplies                   | 48,697                  | 47,033     | 4      | %  |
| Services                   | 7,111                   | 4,819      | 48     | %  |
| Total Newborn Care Revenue | 123,162                 | 120,440    | 2      | %  |
| Total Revenue              | \$355,834               | \$344,112  | 3      | %  |

For the year ended December 31, 2014, Neurology revenue increased by 4% compared to the prior year with the growth coming primarily from the domestic market. Devices and Systems revenue increased 6% for the year ended December 31, 2014 compared to the prior year driven mainly by growth in our EEG, EMG, and PSG product lines in both the domestic and international





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markets. Supplies revenue for the twelve-month period declined 2% compared to the prior year due mainly to decline in sales to international customers.

For the year ended December 31, 2014, Newborn Care revenue increased by 2% compared to the prior year.

Geographically, the increase occurred in our domestic market. Other factors contributing to the increase were the increase in Supplies sales, introduction of two new products in the hearing and phototherapy market segments, and the introduction of Peloton, our hearing screening service initiative.

No single customer accounted for more than 10% of our revenue in either 2014 or 2013. Revenue from domestic sales increased 8% to \$215.5 million in 2014, from \$199.6 million in 2013. Revenue from international sales increased 3% to \$140.3 million in 2014 compared to \$144.5 million in 2013. Revenue from domestic sales was 61% of total revenue in 2014 compared to 58% of total revenue in 2013, and revenue from international sales was 39% of total revenue in 2014 compared to 42% of total revenue in 2013.

**Cost of Revenue and Gross Profit**

|                          | Year ended December 31, |           |   |
|--------------------------|-------------------------|-----------|---|
|                          | 2014                    | 2013      |   |
| Revenue                  | \$355,834               | \$344,112 |   |
| Cost of revenue          | 138,480                 | 138,788   |   |
| Intangibles amortization | 2,967                   | 2,912     |   |
| Gross profit             | 214,387                 | 202,412   |   |
| Gross profit percentage  | 60.2                    | % 58.8    | % |

For the year ended December 31, 2014, our gross profit as a percentage of sales increased by 1.4% compared to the prior year. This increase in gross profit was driven by higher domestic revenues which generally have higher gross margins than international sales, as well as cost reduction initiatives which are resulting in higher margins primarily in Neurology devices.

**Operating Costs**

|                            | Year ended December 31, |          |   |
|----------------------------|-------------------------|----------|---|
|                            | 2014                    | 2013     |   |
| Marketing and selling      | \$85,729                | \$83,138 |   |
| Percentage of revenue      | 24.1                    | % 24.2   | % |
| Research and development   | \$30,100                | \$30,786 |   |
| Percentage of revenue      | 8.5                     | % 8.9    | % |
| General and administrative | \$45,444                | \$43,380 |   |
| Percentage of revenue      | 12.8                    | % 12.6   | % |
| Intangibles Amortization   | \$3,025                 | \$5,681  |   |
| Percentage of revenue      | 0.9                     | % 1.7    | % |
| Restructuring              | \$4,238                 | \$4,767  |   |
| Percentage of revenue      | 1.2                     | % 1.4    | % |

Marketing and selling expenses as a percentage of revenue decreased in 2014 compared to 2013. The increase in expense is related to higher commissions and additional labor costs associated with our Peloton business.

**Research and Development**

Research and development expenses decreased during the year ended December 31, 2014 compared to the prior year. This decrease was primarily due to a reduction in payroll expenses driven by our ongoing cost reduction activities.

**General and Administrative**

General and administrative expenses increased during the year ended December 31, 2014 compared to the prior year. This increase was due to an increase in bad debt expense due to a number of accounts that were deemed uncollectible and increase in incentive compensation due to higher achievement of earnings and revenue goals in 2014.

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### Intangible Amortization

Intangibles amortization decreased during the year ended December 31, 2014 compared to the prior year. During the second quarter of 2014 we identified an inaccuracy related to intangibles amortization. Amortization expense was being recorded on a straight line basis in U.S. dollars for foreign entities when the expense should have been recorded on a straight line basis in the entities' functional currency. As a result there was a \$1.1 million adjustment to reduce amortization expense in the second quarter of 2014 related to prior periods. In addition, we recorded a \$0.6 million impairment in 2014 compared to a \$1.5 million impairment in 2013 related to various trade names acquired.

### Restructuring

Restructuring expenses decreased during the year ended December 31, 2014 compared to the prior year. During 2014 we listed our manufacturing facility in Mundelein, Illinois for sale. We adjusted the carrying value of this asset to fair market value less cost to sell. The related expense of \$2.2 million, which included impairment of building improvements, was recorded in the third quarter of 2014. In 2013, expenses related primarily to restructuring of the executive team for \$1.4 million and acquisition start-up costs for \$1.3 million.

### Other Income (Expense), net

Other income (expense), net consists of interest income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income (expense), net of \$158,000 in 2014, compared to \$(2.7) million in 2013. Interest income of \$119,000 in 2014 was \$87,000 greater than the amount reported for 2013. We reported \$37,000 of foreign currency exchange losses in 2014 versus \$1.4 million of foreign exchange losses in 2013. This decrease was driven primarily by the reclassification in 2014 of \$1.2 million of revaluation on certain intercompany loans from Other Comprehensive Income to Foreign Exchange Gains identified in Note 14, Other Income (Expense), Net. Interest expense was \$438,000 in 2014 compared to \$1.7 million in 2013. The decrease was driven by the repayment in full in 2014 of our term loan.

### Provision for Income Tax

We recorded income tax expense of \$13.5 million and \$8.8 million in 2014 and 2013, respectively. Our effective tax rate was 29.4% and 27.5% for the years ended December 31, 2014 and 2013, respectively. The higher income tax expense in 2014 is primarily the result of higher pretax earnings. The higher effective tax rate in 2014 compared with 2013 is primarily due to increase in uncertain tax positions. These items increased the effective tax rate by 1.1% in 2014. In addition, a significant item impacting the provision for income taxes in 2013 was the income tax benefit derived from the recognition of the federal research and development tax credit enacted by the American Taxpayer Relief Act of 2012. In 2013 we recognized the benefit for both 2012 and 2013 compared with 2014 which only included recognition of the 2014 credits.

Table of Contents**Liquidity and Capital Resources**

Liquidity is our ability to generate sufficient cash flows from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate financing and to raise capital. Therefore, liquidity cannot be considered separately from capital resources that consist of our current funds and the potential to increase those funds in the future. We plan to use these resources in meeting our commitments and in achieving our business objectives.

We believe that our current cash and cash equivalents and any cash generated from operations will be sufficient to meet our ongoing operating requirements for the foreseeable future.

As of December 31, 2015, we had cash and cash equivalents outside the U.S. in certain of our foreign operations of \$60.2 million. We currently intend to permanently reinvest the cash held by our foreign subsidiaries. If, however, a portion of these funds were needed for and distributed to our operations in the United States, we would be subject to additional U.S. income taxes and foreign withholding taxes. The amount of taxes due would depend on the amount and manner of repatriation, as well as the location from where the funds were repatriated.

At December 31, 2015 we had a Credit Agreement with Citibank, National Association ("Citibank"). Pursuant to the terms of the Credit Agreement, Citibank agrees, on a non-committed basis, to make loans to us from time to time, not to exceed at any time the aggregate principal amount of \$25 million. The proceeds under the Revolving Line of Credit shall be used by us for working capital and general corporate purposes. The Credit Agreement contains covenants, including covenants relating to maintenance of books and records, financial reporting and notification, compliance with laws, maintenance of properties and insurance, and limitations on guaranties, investments, issuance of debt, lease obligations and capital expenditures. The Credit Agreement provides for events of default, including failure to pay any principal or interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. Concurrent with the execution of the Credit Agreement, we exited an existing and previously disclosed credit agreement between us and Wells Fargo, N.A. We have no other significant credit facilities.

|   | December 31,<br>2015 | December 31,<br>2014 | December 31,<br>2013 |
|---|----------------------|----------------------|----------------------|
| Cash and cash equivalents                           | \$82,469             | \$66,558             | \$56,106             |
| Debt  | —                    | —                    | 38,017               |
| Working capital                                     | 164,248              | 148,665              | 118,585              |
|   | Year Ended           |                      |                      |
|   | December 31,<br>2015 | December 31,<br>2014 | December 31,<br>2013 |
| Net cash provided by operating activities           | \$36,852             | \$42,143             | \$36,797             |
| Net cash used in investing activities               | (19,478)             | (10,645)             | (22,300)             |
| Net cash provided by (used in) financing activities | 832                  | (20,914)             | 17,247               |

**Comparison of 2015, 2014, and 2013**

During 2015 cash generated from operating activities of \$36.9 million was the result of \$37.9 million of net income, non-cash adjustment to net income of \$28.0 million, and net cash outflows of \$29.1 million from changes in operating assets and liabilities. Cash used in investing activities during the period was \$19.5 million and consisted primarily of cash used related to the acquisition of GND, Monarch and NicView. Cash used to acquire other property and equipment and intangible assets was \$5.4 million. Cash provided by financing activities during the year ended December 31, 2015 was \$831,000 and consisted of proceeds from stock option exercises and Employee Stock Purchase Program ("ESPP") purchases and their related tax benefits of \$17.4 million, offset by \$11.5 million for repurchases of common stock under our share repurchase program, \$4.3 million for taxes paid related to net share settlement of equity awards, and \$0.7 million for contingent consideration payment to Tender Touch, which we acquired in 2014.

During 2014 cash generated from operating activities of \$42.1 million was the result of \$32.5 million of net income, non-cash adjustments to net income of \$16.4 million, and net cash outflows of \$6.7 million from changes in operating assets and liabilities. Cash used in investing activities during the period was \$10.6 million and consisted primarily of

cash used related to the acquisition of Tender Touch, the purchase accounting adjustments for inventory purchases commitments for Grass of \$1.8 million, and cash used to acquire property and equipment and intangible assets of \$5.1 million. Cash used in financing activities was \$20.9 million and consisted of proceeds from stock option exercises and Employee Stock Purchase Program (“ESPP”) purchases and their related tax benefits of \$23.7 million, offset by a repayment of long term debt of \$38.0 million, \$4.6 million

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for repurchases of common stock under our share repurchase program, and \$2.0 million for taxes paid related to net share settlement of equity awards.

During 2013 cash generated from operating activities of \$36.8 million was the result of \$23.1 million of net income, non-cash adjustments to net income of \$19.8 million, and net cash outflows of \$6.2 million from changes in operating assets and liabilities. Cash used in investing activities during the period was \$22.3 million and consisted primarily of cash used related to the acquisition of Grass of \$18.6 million and cash used to acquire property and equipment and intangible assets of \$3.7 million. Cash provided by financing activities was \$17.2 million and consisted of proceeds from stock option exercises and ESPP purchases and their related tax benefits of \$12.1 million and \$57.4 million of borrowings, offset by repayment of long term debt of \$52.2 million.

**Future Liquidity**

Our future liquidity and capital requirements will depend on numerous factors, including the:

- Amount and timing of revenue;
- Extent to which our existing and new products gain market acceptance;
- Extent to which we make acquisitions;
- Cost and timing of product development efforts and the success of these development efforts;
- Cost and timing of marketing and selling activities;
- and
- Availability of borrowings under line of credit arrangements and the availability of other means of financing.

**Contractual Obligations**

In the normal course of business, we enter into obligations and commitments that require future contractual payments. The commitments result primarily from purchase orders placed with contract vendors that manufacture some of the components used in our medical devices and related disposable supply products, purchase orders placed for employee benefits and outside services, as well as commitments for leased office space, leased equipment, and bank debt. The following table summarizes our contractual obligations and commercial commitments as of December 31, 2015 (in thousands):

|                                    | Total    | Payments Due by Period |           |           |                      |
|------------------------------------|----------|------------------------|-----------|-----------|----------------------|
|                                    |          | Less than<br>1 Year    | 1-3 Years | 4-5 Years | More than<br>5 Years |
| Unconditional purchase obligations | \$40,339 | \$40,339               | \$—       | \$—       | \$—                  |
| Operating lease obligations        | 20,606   | 3,909                  | 6,455     | 5,263     | 4,979                |
| Total                              | \$60,945 | \$44,248               | \$6,455   | \$5,263   | \$4,979              |

Purchase obligations are defined as agreements to purchase goods or services that are enforceable and legally binding. Included in the purchase obligations category above are obligations related to purchase orders for inventory purchases under our standard terms and conditions and under negotiated agreements with vendors. We expect to receive consideration (products or services) for these purchase obligations. The purchase obligation amounts do not represent all anticipated purchases in the future, but represent only those items for which we are contractually obligated. The table above does not include obligations under employment agreements for services rendered in the ordinary course of business.

We are not able to reasonably estimate the timing of any potential payments for uncertain tax positions under ASC 740, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement 109. As a result, the preceding table excludes any potential future payments related to our ASC 740 liability for uncertain tax positions. See Note 15 of our Consolidated Financial Statements for further discussion on income taxes.

**Quantitative and Qualitative Disclosures about Market Risk**

We develop products in the U.S, Canada, Europe, and Argentina, and sell those products into more than 100 countries throughout the world. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Most of our sales in Europe and Asia are denominated in the U.S. Dollar and Euro and with the acquisitions of Xltex in November 2007, Medix in 2010 and Nicolet in 2012, a portion of our sales are now denominated in Canadian dollar, Argentine peso and British pound. As

our sales in currencies other than the U.S. dollar increase, our exposure to foreign currency fluctuations may increase.

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In addition, changes in exchange rates also may affect the end-user prices of our products compared to those of our foreign competitors, who may be selling their products based on local currency pricing. These factors may make our products less competitive in some countries.

If the U.S. Dollar uniformly increased or decreased in strength by 10% relative to the currencies in which our sales were denominated, our net income would have correspondingly increased or decreased by an immaterial amount for the year ended December 31, 2015.

Our interest income is sensitive to changes in the general level of interest rates in the U.S. However, because current market conditions have resulted in historically low rates of return on our investments, a hypothetical decrease of 10% in market interest rates would not result in a material decrease in interest income earned on investments held at December 31, 2015.

All of the potential changes noted above are based on sensitivity analyses performed on our financial position as of December 31, 2015. Actual results may differ as our analysis of the effects of changes in interest rates does not account for, among other things, sales of securities prior to maturity and repurchase of replacement securities, the change in mix or quality of the investments in the portfolio, and changes in the relationship between short-term and long-term interest rates.

### Off-Balance Sheet Arrangements

Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. We have a directors and officers' liability insurance policy that limits our exposure and enables us to recover a portion of any future amounts paid resulting from the indemnification of our officers and directors. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. In some cases we have obtained liability insurance providing coverage that limits our exposure for these other indemnified matters. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these indemnification agreements is minimal and have not recorded a liability for these agreements as of December 31, 2015. We had no other off-balance sheet arrangements during any of fiscal 2015, 2014 or 2013 that had, or are reasonably likely to have, a material effect on our consolidated financial condition, results of operations, or liquidity.

### Recent Accounting Pronouncements

See Note 1—Organization and Significant Accounting Policies to the Consolidated Financial Statements contained herein for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of our operations and financial condition.

### Cautionary Information Regarding Forward Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 about Natus Medical Incorporated. These statements include, among other things, statements concerning our expectations, beliefs, plans, intentions, future operations, financial condition and prospects, and business strategies. The words “may,” “will,” “continue,” “estimate,” “project,” “intend,” “believe,” “expect,” “anticipate,” and other similar expressions generally identify forward-looking statements. Forward-looking statements in this Item 7 include, but are not limited to, statements regarding the following: our ability to capitalize on improving market conditions, the sufficiency of our current cash, cash equivalents and short-term investment balances, and any cash generated from operations to meet our ongoing operating and capital requirements for the foreseeable future, and our intent to acquire additional technologies, products or businesses.

Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause the actual results predicted in the forward-looking statements as well as our future financial condition and results of operations to differ materially from our historical results or currently anticipated results. Investors should carefully review the information contained under the caption “Risk Factors” contained in Item 1A of this report for a description of risks and uncertainties. All forward-looking statements are based on information available to us on the date hereof, and we assume no obligation to update forward-looking statements.

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## ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by this Item is set forth in the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations—Quantitative and Qualitative Disclosures About Market Risk, and is incorporated by reference in this section.

## ITEM 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements and Supplementary Data required by this Item are set forth where indicated in Item 15 of this report.

## Selected Quarterly Financial Data (Unaudited)

The following table presents our operating results for each of the eight quarters in the period ending December 31, 2015. The information for each of these quarters is unaudited and has been prepared on the same basis as our audited financial statements appearing elsewhere in this report.

In the opinion of our management all necessary adjustments, including normal recurring adjustments, have been included to present fairly the unaudited quarterly results when read in conjunction with our audited Consolidated Financial Statements and the related notes appearing elsewhere in this report. These operating results are not necessarily indicative of the results of any future period.

|  | Quarters Ended                   |                    |               |                |                   |                    |               |                |
|--|----------------------------------|--------------------|---------------|----------------|-------------------|--------------------|---------------|----------------|
|  | December 31, 2015                | September 30, 2015 | June 30, 2015 | March 31, 2015 | December 31, 2014 | September 30, 2014 | June 30, 2014 | March 31, 2014 |
|  | (in thousands, except per share) |                    |               |                |                   |                    |               |                |
| Revenue                                | \$99,950                         | \$94,583           | \$91,937      | \$89,395       | \$94,010          | \$89,876           | \$86,325      | \$85,624       |
| Cost of revenue                        | 41,023                           | 35,520             | 33,844        | 35,105         | 35,820            | 33,180             | 35,500        | 33,981         |
| Intangibles amortization               | 788                              | 683                | 683           | 682            | 711               | 1,054              | 156           | 1,046          |
| Gross profit                           | 58,139                           | 58,380             | 57,410        | 53,608         | 57,479            | 55,642             | 50,669        | 50,597         |
| Operating expenses:                    |                                  |                    |               |                |                   |                    |               |                |
| Marketing and selling                  | 22,330                           | 22,495             | 22,108        | 20,742         | 22,915            | 20,123             | 22,061        | 20,630         |
| Research and development               | 8,568                            | 7,700              | 7,309         | 6,857          | 7,827             | 7,462              | 7,634         | 7,177          |
| General and administrative             | 13,124                           | 10,031             | 11,656        | 11,552         | 10,810            | 12,740             | 10,165        | 11,729         |
| Intangibles amortization               | 2,282                            | 2,036              | 2,174         | 955            | 1,651             | (408 )             | 646           | 1,136          |
| Restructuring                          | 1,786                            | 42                 | 161           | 156            | 634               | 2,848              | 218           | 538            |
| Total operating expenses               | 48,090                           | 42,304             | 43,408        | 40,262         | 43,837            | 42,765             | 40,724        | 41,210         |
| Income from operations                 | 10,049                           | 16,076             | 14,002        | 13,346         | 13,642            | 12,877             | 9,945         | 9,387          |
| Other income (expense), net            | 138                              | 7                  | (380 )        | (829 )         | 498               | (1,447 )           | 795           | 312            |
| Income before provision for income tax | 10,187                           | 16,083             | 13,622        | 12,517         | 14,140            | 11,430             | 10,740        | 9,699          |
| Provision for income tax               | 1,643                            | 5,151              | 3,771         | 3,920          | 3,701             | 3,607              | 3,279         | 2,944          |
| Net income                             | \$8,544                          | \$10,932           | \$9,851       | \$8,597        | \$10,439          | \$7,823            | \$7,461       | \$6,755        |
| Earnings per share:                    |                                  |                    |               |                |                   |                    |               |                |
| Basic                                  | \$0.26                           | \$0.34             | \$0.31        | \$0.27         | \$0.33            | \$0.25             | \$0.24        | \$0.22         |
| Diluted                                | \$0.26                           | \$0.33             | \$0.30        | \$0.26         | \$0.32            | \$0.24             | \$0.23        | \$0.21         |





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|  | Quarters Ended                   |                    |               |                |                   |                    |               |                |
|--|----------------------------------|--------------------|---------------|----------------|-------------------|--------------------|---------------|----------------|
|  | December 31, 2015                | September 30, 2015 | June 30, 2015 | March 31, 2015 | December 31, 2014 | September 30, 2014 | June 30, 2014 | March 31, 2014 |
|  | (in thousands, except per share) |                    |               |                |                   |                    |               |                |
| Weighted average shares used in the calculation of net earnings per share: |                                  |                    |               |                |                   |                    |               |                |
| Basic  | 32,554                           | 32,432             | 32,273        | 32,127         | 31,916            | 31,584             | 31,424        | 31,062         |
| Diluted  | 33,327                           | 33,253             | 33,204        | 33,097         | 32,908            | 32,615             | 32,444        | 32,185         |

## ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## ITEM 9A. Controls and Procedures

## Evaluation of Disclosure Controls and Procedures

Under the rules of the Securities and Exchange Commission, “disclosure controls and procedures” are controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud due to inherent limitations of internal controls. Because of such limitations, there is a risk that material misstatements will not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Our management, with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our management, including our chief executive officer and chief financial officer, has concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of December 31, 2015.

## Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Our management, under the supervision of our chief executive officer and our chief financial officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the criteria set forth in the COSO Framework, our management concluded that as of December 31, 2015 our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting.

KPMG LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements and financial statement schedule included in this annual report. They also audited our internal control over financial reporting as of December 31, 2015 as stated in their report included in this annual report.

## Changes in Internal Control over Financial Reporting

During the year ended December 31, 2015, we implemented internal control procedures to address previously identified material weakness in our financial reporting process. We made substantive changes to enhance the sufficiency of our resources in 2014 and 2015. Specifically, we added additional resources with expertise in inventory cost accounting and have redesigned our controls to ensure the proper capitalization of overhead costs and the proper

monitoring of inventory valuation. We have also added additional resources within our credit and collections group during 2014 and 2015. We have added incremental resources in 2015 to enhance the design and operating effectiveness of our controls over accounts receivable, inventory, and revenue recognition. We finalized our world-wide implementation of a single ERP system during the third quarter of 2015, a project we began in 2011 to consolidate eight different systems into one global platform. The completion of this project eliminates duplicative processes and increases the capacity of our existing accounting and financial reporting resources. After completing our testing of

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the design and operating effectiveness of these new procedures, we concluded that we have remediated the previously identified material weakness as of December 31, 2015.

Attestation Report of the Independent Registered Public Accounting Firm

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Natus Medical Incorporated:

We have audited Natus Medical Incorporated and subsidiaries (the Company) internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing under Item 9A of the Company's December 31, 2015 annual report on Form 10-K. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Natus Medical Incorporated and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Natus Medical Incorporated and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2015, and our report dated February 26, 2016 expressed an unqualified opinion on those consolidated financial statements.

(signed) KPMG LLP

San Francisco, California

February 26, 2016

Table of Contents**PART III**

This Part incorporates certain information from our definitive Proxy Statement for our 2015 Annual Meeting of Stockholders that is to be filed with the Securities and Exchange Commission not later than 120 days after the end of our fiscal year covered by this Report on Form 10-K.

**ITEM 10. Directors, Executive Officers, and Corporate Governance**

The information required by this Item concerning our directors is incorporated by reference to our 2016 Proxy Statement including but not necessarily limited to the section entitled Election of Directors. Certain information required by this item concerning executive officers is set forth in Part I of this Report in Business—Executive Officers. The information required by this item concerning compliance with Section 16(a) of the Exchange Act of 1934, as amended (the “Exchange Act”), is incorporated by reference to the 2016 Proxy Statement including but not necessarily limited to the section entitled Section 16(a) Beneficial Ownership Reporting Compliance.

**Audit Committee and Audit Committee Financial Expert**

The members of the Audit Committee of our Board of Directors are Kenneth E. Ludlum, Robert A. Gunst, and William M. Moore. Our Board of Directors has determined that Kenneth E. Ludlum is an audit committee financial expert as defined in Item 407(d) of Regulation S-K. All of the members of our audit committee are considered “independent” as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

**Code of Conduct and Ethics**

We have a code of conduct and ethics that applies to all of our employees, including our principal executive officer, principal financial officer, and principal accounting officer or controller. This code of conduct and ethics is posted on our internet website. The internet address for our website is [www.natus.com](http://www.natus.com), and the code of conduct and ethics may be found in the “Governance” section of our “Investor” webpage.

We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding certain amendments to, or waivers from, provisions of this code of conduct and ethics by posting such information on our website, at the address and location specified above, or as otherwise required by The NASDAQ Stock Market.

The information required by this Item concerning our corporate governance is incorporated by reference to our 2016 Proxy Statement including but not necessarily limited to the section entitled Corporate Governance.

**ITEM 11. Executive Compensation**

The information required by this Item is incorporated by reference to our 2016 Proxy Statement including but not necessarily limited to the section entitled Executive Compensation.

**ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**  
**Equity Compensation Plan Information**

The following table sets forth information about the number of shares of common stock that can be issued under our 2011 Stock Awards Plan, as amended, and our 2011 Employee Stock Purchase Plan as of December 31, 2015.

| Plan Category  | Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants, Awards and Rights | Weighted-Average Exercise Price of Outstanding Options, Warrants Awards and Rights | Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (excluding securities reflected in the first column) |
|--|---|--|---|
| Equity compensation plans approved by security holders     | 1,146,915   | \$ 15.07   | 1,297,008   |
| Equity compensation plans not approved by security holders | —   | —  | —   |
| Total  | 1,146,915   | 15.07  | 1,297,008   |

Additional information required by this Item concerning ownership of our securities by certain beneficial owners and management is incorporated by reference to our 2016 Proxy Statement including but not necessarily limited to the section entitled Beneficial Ownership of Common Stock. Information concerning securities authorized for issuance under equity compensation plans is incorporated by reference to our 2016 Proxy Statement including but not

necessarily limited to the section entitled Equity Compensation Plan Information.

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ITEM 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated by reference to the 2016 Proxy Statement including but not necessarily limited to the section entitled Corporate Governance Principles and Board Matters—Certain Relationships and Policies on Related Party Transactions.

ITEM 14. Principal Accounting Fees and Services

The information required by this Item is incorporated by reference to the 2016 Proxy Statement including but not necessarily limited to the section entitled Audit Fees.



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## PART IV

## ITEM 15. Exhibits, Financial Statement Schedules

## (a)(1) Financial Statements

The following Consolidated Financial Statements are filed as part of this Report:

|   |             |
|---|-------------|
|   | Page        |
| <u>Reports of Independent Registered Public Accounting Firms</u>  | F- <u>2</u> |
| <u>Consolidated Balance Sheets</u>                                | F- <u>4</u> |
| <u>Consolidated Statements of Income and Comprehensive Income</u> | F- <u>5</u> |
| <u>Consolidated Statements of Stockholders' Equity</u>            | F- <u>6</u> |
| <u>Consolidated Statements of Cash Flows</u>                      | F- <u>7</u> |
| <u>Notes to Consolidated Financial Statements</u>                 | F- <u>8</u> |

## (a)(2) Financial Statement Schedule

## SCHEDULE II: VALUATION AND QUALIFYING ACCOUNTS

For the years ended December 31, 2015, 2014 and 2013

(in thousands)

|                                 | Balance at<br>Beginning<br>of Period | Additions<br>Charged to<br>Expense | Deductions | Balance<br>at End<br>of Period |
|---------------------------------|--------------------------------------|------------------------------------|------------|--------------------------------|
| Year ended December 31, 2015    |                                      |                                    |            |                                |
| Allowance for doubtful accounts | \$4,324                              | \$1,496                            | \$(1,134)  | ) \$4,686                      |
| Valuation allowance             | 3,151                                | 821                                | —          | 3,972                          |
| Year ended December 31, 2014    |                                      |                                    |            |                                |
| Allowance for doubtful accounts | \$2,962                              | \$1,221                            | \$141      | \$4,324                        |
| Valuation allowance             | 5,043                                | —                                  | (1,892)    | ) 3,151                        |
| Year ended December 31, 2013    |                                      |                                    |            |                                |
| Allowance for doubtful accounts | \$2,617                              | \$277                              | \$68       | \$2,962                        |
| Valuation allowance             | 4,339                                | 704                                | —          | 5,043                          |

## (a)(3) Exhibits

The Exhibits listed in the Index to Exhibits, which appears immediately following the signature page and is incorporated herein by reference, are filed as part of this 10-K.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

## NATUS MEDICAL INCORPORATED

By /s/ JAMES B. HAWKINS  
James B. Hawkins  
President and Chief Executive Officer

By /s/ JONATHAN A. KENNEDY  
Jonathan A. Kennedy  
Senior Vice President and Chief Financial Officer

Dated: February 26, 2016

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints James B. Hawkins and Jonathan Kennedy and each of them acting individually, as his or her attorney-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any and all amendments to this Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons on behalf of the registrant and in the capacity and dates indicated:

| Signature  | Title  | Date              |
|--|--|-------------------|
| /S/ JAMES B. HAWKINS<br>(James B. Hawkins)       | President and Chief Executive Officer (Principal Executive Officer)                          | February 26, 2016 |
| /S/ JONATHAN A. KENNEDY<br>(Jonathan A. Kennedy) | Senior Vice President & Chief Financial Officer (Principal Financial and Accounting Officer) | February 26, 2016 |
| /S/ ROBERT A. GUNST<br>(Robert A. Gunst)         | Chairman of the Board of Directors   | February 26, 2016 |
| /S/ DORIS ENGIBOUS<br>(Doris Engibous)           | Director   | February 26, 2016 |
| /S/ KENNETH E. LUDLUM<br>(Kenneth E. Ludlum)     | Director   | February 26, 2016 |
| /S/ WILLIAM M. MOORE<br>(William M. Moore)       | Director   | February 26, 2016 |

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NATUS MEDICAL INCORPORATED  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Natus Medical Incorporated:

We have audited the accompanying consolidated balance sheets of Natus Medical Incorporated and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2015. In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Natus Medical Incorporated and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the years in the two year period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Natus Medical Incorporated's internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 26, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

(signed) KPMG LLP

San Francisco, California

February 26, 2016

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Natus Medical Incorporated  
San Carlos, California

We have audited the accompanying consolidated statements of income and comprehensive income, stockholders' equity, and cash flows of Natus Medical Incorporated and subsidiaries (the "Company") for the year ended December 31, 2013. Our audit also included the financial statement schedule listed at Item 15(a)(2) for the year ended December 31, 2013. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and the financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2013 consolidated financial statements present fairly, in all material respects, the results of operations and cash flows of the Company for the year ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule for the year ended December 31, 2013, when considered in relation to the 2013 basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche LLP  
San Francisco, CA

March 17, 2014 (March 16, 2015 as to the effect of the revision described in Footnote 21)

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CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

|   | December 31,<br>2015 | 2014      |
|---|----------------------|-----------|
| <b>ASSETS</b>   |                      |           |
| Current assets:   |                      |           |
| Cash and cash equivalents   | \$82,469             | \$66,558  |
| Accounts receivable, net of allowance for doubtful accounts of \$4,686 and \$4,324  | 99,080               | 82,277    |
| Inventories   | 48,572               | 40,051    |
| Prepaid expenses and other current assets   | 11,235               | 17,408    |
| Deferred income tax   | —                    | 11,511    |
| Total current assets  | 241,356              | 217,805   |
| Property and equipment, net   | 16,967               | 17,923    |
| Intangible assets, net  | 86,536               | 92,761    |
| Goodwill  | 107,466              | 96,316    |
| Deferred income tax   | 12,782               | 1,152     |
| Other assets  | 14,389               | 8,864     |
| Total assets  | \$479,496            | \$434,821 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |           |
| Current liabilities:  |                      |           |
| Accounts payable  | \$23,660             | \$21,371  |
| Accrued liabilities   | 42,137               | 36,024    |
| Deferred revenue  | 11,311               | 11,745    |
| Total current liabilities   | 77,108               | 69,140    |
| Long-term liabilities:  |                      |           |
| Other liabilities   | 7,781                | 4,859     |
| Deferred income tax   | 3,897                | 8,107     |
| Total liabilities   | 88,786               | 82,106    |
| Commitments and contingencies (Note 19)   |                      |           |
| Stockholders' equity:   |                      |           |
| Common stock, \$0.001 par value; 120,000,000 shares authorized; shares issued and outstanding 33,153,500 in 2015 and 32,649,158 in 2014 | 323,745              | 315,296   |
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized; no shares issued and outstanding in 2015 and in 2014                  | —                    | —         |
| Retained earnings   | 106,814              | 68,890    |
| Accumulated other comprehensive loss  | (39,849)             | (31,471)  |
| Total stockholders' equity  | 390,710              | 352,715   |
| Total liabilities and stockholders' equity  | \$479,496            | \$434,821 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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## NATUS MEDICAL INCORPORATED

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except per share amounts)

|  | Years Ended December 31, |           |            |
|--|--------------------------|-----------|------------|
|  | 2015                     | 2014      | 2013       |
| Revenue  | \$375,865                | \$355,834 | \$344,112  |
| Cost of revenue  | 145,492                  | 138,480   | 138,788    |
| Intangibles amortization   | 2,836                    | 2,967     | 2,912      |
| Gross profit   | 227,537                  | 214,387   | 202,412    |
| Operating expenses:  |                          |           |            |
| Marketing and selling  | 87,675                   | 85,729    | 83,138     |
| Research and development   | 30,434                   | 30,100    | 30,786     |
| General and administrative   | 46,363                   | 45,444    | 43,380     |
| Intangibles amortization   | 7,447                    | 3,025     | 5,681      |
| Restructuring  | 2,145                    | 4,238     | 4,767      |
| Total operating expenses   | 174,064                  | 168,536   | 167,752    |
| Income from operations   | 53,473                   | 45,851    | 34,660     |
| Other income (expense), net  | (1,064                   | ) 158     | (2,716 )   |
| Income before provision for income tax                                   | 52,409                   | 46,009    | 31,944     |
| Provision for income tax   | 14,485                   | 13,531    | 8,797      |
| Net income   | \$37,924                 | \$32,478  | \$23,147   |
| Foreign currency translation adjustment                                  | (8,378                   | ) (11,218 | ) (1,972 ) |
| Comprehensive income   | \$29,546                 | \$21,260  | \$21,175   |
| Net income per share:  |                          |           |            |
| Basic  | \$1.17                   | \$1.03    | \$0.77     |
| Diluted  | \$1.14                   | \$1.00    | \$0.75     |
| Weighted average shares used in the calculation of net income per share: |                          |           |            |
| Basic  | 32,348                   | 31,499    | 29,993     |
| Diluted  | 33,241                   | 32,568    | 30,821     |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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## NATUS MEDICAL INCORPORATED

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share amounts)

|   | Common Stock |           | Retained  | Accumulated              | Stockholders' |
|---|--------------|-----------|-----------|--------------------------|---------------|
|   | Shares       | Amount    | Earnings  | Other Comprehensive Loss | Equity        |
| Balances, December 31, 2012                                 | 30,106,933   | 275,395   | 13,265    | (18,281                  | ) 270,379     |
| Tax benefit of options exercises                            | —            | 1,601     | —         | —                        | 1,601         |
| Vesting of restricted stock units                           | 6,224        | —         | —         | —                        | —             |
| Net issuance of restricted stock awards                     | 159,935      | —         | —         | —                        | —             |
| Employee stock purchase plan                                | 69,780       | 1,061     | —         | —                        | 1,061         |
| Stock-based compensation expense                            | —            | 5,919     | —         | —                        | 5,919         |
| Exercise of stock options                                   | 1,058,730    | 8,079     | —         | —                        | 8,079         |
| Foreign currency translation adjustment                     | —            | —         | —         | (1,972                   | ) (1,972      |
| Net income  | —            | —         | 23,147    | —                        | 23,147        |
| Balances, December 31, 2013                                 | 31,401,602   | 292,055   | 36,412    | (20,253                  | ) 308,214     |
| Tax benefit of options exercises                            | —            | 7,525     | —         | —                        | 7,525         |
| Vesting of restricted stock units                           | 13,121       | —         | —         | —                        | —             |
| Net issuance of restricted stock awards                     | 180,665      | —         | —         | —                        | —             |
| Employee stock purchase plan                                | 45,625       | 1,197     | —         | —                        | 1,197         |
| Stock-based compensation expense                            | —            | 6,062     | —         | —                        | 6,062         |
| Repurchase of company stock                                 | (161,400     | ) (4,633  | ) —       | —                        | (4,633        |
| Taxes paid related to net share settlement of equity awards | (73,134      | ) (1,999  | ) —       | —                        | (1,999        |
| Exercise of stock options                                   | 1,242,679    | 15,089    | —         | —                        | 15,089        |
| Foreign currency translation adjustment                     | —            | —         | —         | (11,218                  | ) (11,218     |
| Net income  | —            | —         | 32,478    | —                        | 32,478        |
| Balances, December 31, 2014                                 | 32,649,158   | \$315,296 | \$68,890  | \$(31,471                | ) \$352,715   |
| Tax benefit of options exercises                            | —            | 7,104     | —         | —                        | 7,104         |
| Vesting of restricted stock units                           | 21,619       | —         | —         | —                        | —             |
| Net issuance of restricted stock awards                     | 199,620      | —         | —         | —                        | —             |
| Employee stock purchase plan                                | 35,467       | 1,251     | —         | —                        | 1,251         |
| Stock-based compensation expense                            | —            | 6,953     | —         | —                        | 6,953         |
| Repurchase of company stock                                 | (281,915     | ) (11,526 | ) —       | —                        | (11,526       |
| Taxes paid related to net share settlement of equity awards | (102,112     | ) (4,341  | ) —       | —                        | (4,341        |
| Exercise of stock options                                   | 631,663      | 9,008     | —         | —                        | 9,008         |
| Foreign currency translation adjustment                     | —            | —         | —         | (8,378                   | ) (8,378      |
| Net income  | —            | —         | 37,924    | —                        | 37,924        |
| Balances, December 31, 2015                                 | 33,153,500   | \$323,745 | \$106,814 | \$(39,849                | ) \$390,710   |

The accompanying notes are an integral part of these Consolidated Financial Statements.





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NATUS MEDICAL INCORPORATED  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|  | Year Ended December 31, |           |            |
|--|-------------------------|-----------|------------|
|  | 2015                    | 2014      | 2013       |
| Operating activities:  |                         |           |            |
| Net income   | \$37,924                | \$32,478  | \$23,147   |
| Adjustments to reconcile net income to net cash provided by operating activities:                    |                         |           |            |
| Provision for losses on accounts receivable  | 1,496                   | 991       | 277        |
| Excess tax benefit on the exercise of stock options  | (7,104)                 | ) (7,525  | ) (3,109)  |
| Depreciation and amortization  | 15,987                  | 11,759    | 12,848     |
| Gain on disposal of property and equipment   | (5)                     | ) —       | —          |
| Impairment of intangible assets  | —                       | 598       | 1,500      |
| Impairment of property and equipment   | —                       | 2,177     | 292        |
| Warranty reserve   | 10,729                  | 2,306     | 1,938      |
| Stock-based compensation   | 6,953                   | 6,062     | 6,078      |
| Changes in operating assets and liabilities, net of assets and liabilities acquired in acquisitions: |                         |           |            |
| Accounts receivable  | (15,272)                | ) (2,431  | ) 9,357    |
| Inventories  | (12,232)                | ) (2,017  | ) (2,679)  |
| Other assets   | 858                     | (3,667    | ) (6,899)  |
| Accounts payable   | 3,270                   | (7,648    | ) (1,387)  |
| Accrued liabilities  | (6,177)                 | ) 6,595   | (5,301)    |
| Deferred revenue   | (1,118)                 | ) (775    | ) (768)    |
| Deferred taxes   | 1,543                   | 3,240     | 1,503      |
| Net cash provided by operating activities  | 36,852                  | 42,143    | 36,797     |
| Investing activities:  |                         |           |            |
| Acquisition of businesses, net of cash acquired  | (14,284)                | ) (4,925  | ) (18,600) |
| Acquisition of property and equipment  | (4,068)                 | ) (4,239  | ) (1,825)  |
| Acquisition of intangible assets   | (1,126)                 | ) (1,481  | ) (1,875)  |
| Net cash used in investing activities  | (19,478)                | ) (10,645 | ) (22,300) |
| Financing activities:  |                         |           |            |
| Proceeds from stock option exercises and ESPP  | 10,258                  | 16,210    | 8,981      |
| Excess tax benefit on the exercise of stock options  | 7,104                   | 7,525     | 3,109      |
| Repurchase of company stock  | (11,525)                | ) (4,633  | ) —        |
| Taxes paid related to net share settlement of equity awards  | (4,341)                 | ) (1,999  | ) —        |
| Proceeds from short-term borrowings  | —                       | —         | 22,000     |
| Proceeds from long-term borrowings   | —                       | —         | 35,383     |
| Contingent consideration earn-out  | (664)                   | ) —       | —          |
| Payments on borrowings   | —                       | (38,017   | ) (52,226) |
| Net cash (used in)/provided by financing activities  | 832                     | (20,914   | ) 17,247   |
| Exchange rate effect on cash and cash equivalents  | (2,295)                 | ) (132    | ) 1,305    |
| Net increase in cash and cash equivalents  | 15,911                  | 10,452    | 33,049     |
| Cash and cash equivalents, beginning of year   | 66,558                  | 56,106    | 23,057     |
| Cash and cash equivalents, end of year   | \$82,469                | \$66,558  | \$56,106   |
| Supplemental disclosure of cash flow information:  |                         |           |            |
| Cash paid for interest   | \$—                     | \$434     | \$1,311    |
| Cash paid for income taxes   | \$10,164                | \$5,672   | \$12,908   |

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Non-cash investing activities:

|   |         |         |       |
|---|---------|---------|-------|
| Property and equipment included in accounts payable | \$289   | \$122   | \$80  |
| Inventory transferred to property and equipment     | \$1,056 | \$1,350 | \$991 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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### NATUS MEDICAL INCORPORATED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2015, 2014 and 2013

### 1—ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

#### Organization

Natus Medical Incorporated (“Natus”, the “Company”, “we”, “our”) was incorporated in California in May 1987 and reincorporated in Delaware in August 2000. Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, incubators to control the newborn’s environment, and software systems for managing and tracking disorders and diseases for public health laboratories.

#### Basis of Presentation and Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications to the prior periods have been made to conform to the current period presentation. The consolidated statements of income for 2014 and 2013 reflect reclassifications from Cost of revenue to Intangibles amortization, from Marketing and selling, Research and development, and General and administrative to Intangible amortization, and from General and administrative to Restructuring. In 2015, there have been no adjustments to previously reported net income or shareholder's equity. Refer to Note 21 for discussion of immaterial corrections identified and reported in 2014.

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities in the Consolidated Financial Statements and the reported amount of revenue and expenses during the reporting period. Such estimates include allowances for potentially uncollectible accounts receivable, valuation of inventory, intangible assets, goodwill, share-based compensation, deferred income taxes, reserves for warranty obligations, and the provision for income taxes. Actual results could differ from those estimates.

#### Revenue recognition

Revenue, net of discounts, is recognized from sales of medical devices and supplies, including sales to distributors, when the following conditions have been met: a purchase order has been received, title has transferred, the selling price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Terms of sale for most domestic sales are FOB origin, reflecting that title and risk of loss are assumed by the purchaser at the shipping point; however, terms of sale for some neurology, sleep-diagnostic, and head cooling systems are FOB destination, reflecting that title and risk of loss are assumed by the purchaser upon delivery. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped “ex works,” in which title and risk of loss are assumed by the distributor at the shipping point. For products shipped under FOB origin or EXW terms, delivery is generally considered to have occurred when the product is shipped. Freight charges billed to customers are included in revenue and freight-related expenses are charged to cost of revenue. We generally do not provide rights of return on products. For products containing embedded software, we have determined that the hardware and software components function together to deliver the products’ essential functionality, and therefore, the revenue from the sale of these products does not fall within the scope of the software revenue recognition rules. Our revenue recognition policies for sales of these products are substantially the same as for our other tangible products.

Revenue from sales of certain of our products that remain within the scope of the software revenue recognition rules under ASC Subtopic 985-605 is not significant.

Revenue from extended service and maintenance agreements, for both medical devices and data management systems, is recognized ratably over the service period. Revenue from installation or training services is deferred until such time

service is provided.

Certain revenue transactions include multiple element arrangements. We allocate revenue in these arrangements to each unit of accounting using the relative selling price method. The selling prices used during the allocation process are based on vendor specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE or TPE is available.

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NATUS MEDICAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

Group purchasing organizations (“GPOs”) negotiate volume purchase prices for member hospitals, group practices, and other clinics. Our agreements with GPOs typically contain preferential terms for the GPO and its members, including provisions for some, if not all, of the following:

• Payment of marketing fees by Natus to the GPO, usually based on purchasing experience of group members; and  
• Non-recourse cancellation provisions.

We do not sell products to GPOs. Hospitals, group practices, and other clinics that are members of a GPO purchase products directly from us under the terms negotiated by the GPO. Negotiated pricing and discounts are recognized as a reduction of the selling price of products at the time of the sale. Revenue from sales to members of GPOs is otherwise consistent with general revenue recognition policies as previously described.

**Inventory**

Inventories are carried at the lower of cost or market, with cost being determined using the first-in, first-out method. The carrying value of our inventories is reduced for any difference between cost and estimated market value of inventories that is determined to be obsolete or unmarketable, based upon assumptions about future demand and market conditions. Adjustments to the value of our inventory establish a new cost basis and are considered permanent even if circumstances later suggest that increased carrying amounts are recoverable. If demand is higher than expected, we may sell inventory that had previously been written down.

**Carrying value of intangible assets and goodwill**

We amortize intangible assets with finite lives over their useful lives; any future changes that would limit their useful lives or any determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges.

Goodwill is not amortized but is subject to an annual impairment analysis, which is performed as of October 1st; this assessment is also performed whenever there is a change in circumstances that indicates the carrying value of goodwill may be impaired.

In 2015 and 2014, we performed qualitative assessments to test our reporting units’ goodwill for impairment. Qualitative factors considered in this assessment include industry and market considerations, overall financial performance and other relevant events and factors affecting each reporting unit. Based on our qualitative assessment, we determined that the fair value of each reporting unit was more likely than not to be greater than its carrying amount, and no impairment was recognized.

In 2013 we performed a two-step impairment test on our goodwill. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit to its carrying value, including goodwill. We use a projected discounted cash flow model to determine the fair value of a reporting unit. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and the second step of the impairment test is not required. The second step, if required, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. The fair value of a reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. If the carrying amount of the reporting unit’s goodwill exceeds its implied fair value, an impairment charge is recognized in an amount equal to that excess.

Prior to the assignment of definite lives to our tradenames in the second quarter of 2015 (See Note 6 - Intangible Assets), we tested indefinite lived intangibles for impairment by comparing the carrying value of those assets to be fair value as of the assessment date. We used the relief from royalty method to determine the fair value of the assets. This analysis is dependent upon a number of quantitative and qualitative factors including estimates of forecasted revenue, royalty rate, and taxes. The discount rate applied also has an impact on the estimates of fair value, as use of a higher rate will result in a lower estimate of fair value. As of the October 1, 2014 and 2013 testing dates, we determined that certain trade names were impaired and we recorded impairment charges of \$0.6 million and \$1.5 million, respectively.

Goodwill impairment analysis and measurement is a process that requires significant judgment. Future changes in the judgments and estimates underlying our analysis of goodwill for possible impairment, including expected future cash flows and discount rate, could result in a significantly different estimate of the fair value of the reporting units and could result in additional impairment of goodwill.

Long lived assets

We continually monitor events and changes in circumstances that could indicate that carrying amounts of its long-lived assets, including property and equipment and intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability by determining whether the carrying value of such assets will be recovered

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NATUS MEDICAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

through their undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we will recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

**Liability for product warranties**

We provide a warranty with our products that is generally one year in length and in some cases, regulations may require us to provide repair or remediation beyond our typical warranty period. If any of our products contain defects, we may be required to incur additional repair and remediation costs. Service for domestic customers is provided by Company-owned service centers that perform all service, repair, and calibration services. Service for international customers is provided by a combination of Company-owned facilities and vendors on a contract basis.

A warranty reserve is included in accrued liabilities for the expected future costs of servicing products. Additions to the reserve are based on management's best estimate of probable liability. We consider a combination of factors including material and labor costs, regulatory requirements, and other judgments in determining the amount of the reserve. The reserve is reduced as costs are incurred to honor existing warranty and regulatory obligations.

**Share-based compensation**

We recognize share-based compensation expense associated with employee stock options under the single-option straight line method over the requisite service period, which is generally a four-year vesting period pursuant to ASC Topic 718, Compensation-Stock Compensation. See Note 12 of our Consolidated Financial Statements.

For employee stock options, the value of each option is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of freely traded options. Similar to other option pricing models, the Black-Scholes method requires the input of highly subjective assumptions, including stock price volatility. Changes in the subjective input assumptions can materially affect the estimated fair value of our employee stock options.

We recognize share-based compensation associated with Restricted Stock Awards ("RSA") and Restricted Stock Units ("RSU"). RSAs and RSUs vest ratably over a three-year period for employees. RSAs and RSUs for executives vest over a four-year period; 50% on the second anniversary of the vesting start date and 25% on each of the third and fourth anniversaries of the vesting date. The value is estimated based on the market value of our common stock on the date of issuance pursuant to ASC Topic 718, Compensation-Stock Compensation.

We issue new shares of common stock upon the exercise of stock options and the vesting of RSAs and RSUs.

Forfeitures of employee stock options and awards are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Share-based compensation expense is recorded net of estimated forfeitures, such that expense is recorded only for those share-based awards that are expected to vest. The cash flow from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for employee options (excess tax benefits) is classified as a cash inflow from financing activities and a cash outflow from operating activities in our Statements of Cash Flows. We treat tax deductions from certain stock option exercises as being realized when they reduce taxes payable in accordance with relevant tax law.

**Cash Equivalents**

All highly liquid instruments purchased with an original maturity of three months or less are classified as cash equivalents.

**Allowance for Doubtful Accounts**

We estimate our allowance for estimated uncollectible accounts receivable based on historical collection experience within the markets in which we operate and other customer-specific information, such as bankruptcy filings or liquidity problems of customers. When all internal efforts have been exhausted to collect the receivable, it is written off and relieved from the reserve.

**Fair Value of Financial Instruments**

Financial instruments include cash and cash equivalents, accounts receivable, and accounts payable. Cash is reported at its fair value on the balance sheet dates. The recorded carrying amounts of accounts receivable and accounts



payable approximate their fair values due to their short-term maturities.

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NATUS MEDICAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using the straight-line method over estimated useful lives of the respective assets, which are three to five years for office furniture and equipment, three to five years for computer software and hardware, three years for demonstration and loaned equipment, and 30 to 40 years for buildings. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life. Land is not depreciated. Costs associated with acquiring and installing software to be used for internal purposes are capitalized and amortized on a straight-line basis over three years.

Research & Development Costs

Costs incurred in research and development are charged to operations as incurred.

Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We record net deferred tax assets to the extent we believe it is more likely than not that the assets will be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations. In the event we were to determine that we would be able to realize our deferred income tax assets in the future in excess of their net recorded amount, we would make an adjustment to the valuation allowance which would reduce the provision for income taxes.

We recognize the tax benefit of uncertain tax positions in the financial statements in accordance with ASC Topic 740, Income Tax. When the tax position is deemed more likely than not of being sustained, we recognize the largest amount of tax benefit that is greater than 50 percent likely of being ultimately realized upon settlement, in accordance with ASC 740-10-05.

Foreign Currency

The functional currency of our subsidiaries outside of North America is generally the local currency of the country where the subsidiary is located. Accordingly, foreign currency translation adjustments relating to the translation of foreign subsidiary financial statements are included as a component of accumulated other comprehensive loss. We recorded \$8.4 million, \$11.2 million, and \$2.0 million of foreign currency translation losses for the years ended December 31, 2015, 2014 and 2013, respectively.

Gains and losses from transactions denominated in currencies other than our functional currencies are included in other income and expense. In 2015, 2014, and 2013, net foreign currency transaction losses were \$1.4 million, \$37,000, and \$1.4 million, respectively. Foreign currency gains and losses result primarily from fluctuations in the exchange rate between the U.S. Dollar, Canadian Dollar, Euro, Argentine Peso, British Pound, and Danish Kroner.

Comprehensive Income

We report by major components and as a single total the change in our net assets during the period from non-owner sources in accordance with ASC Topic 220, Comprehensive Income. The consolidated statement of comprehensive income has been included with the consolidated statements of operations. Accumulated other comprehensive income consists of translation gains and losses on foreign subsidiary financial statements.

Basic and Diluted Net Income per Share

We compute net income per share in accordance with ASC Topic 260, Earnings per Share. Basic net income per share is based upon the weighted average number of common shares outstanding during the period. Diluted net income per share is based upon the weighted average number of common shares outstanding and dilutive common stock equivalents outstanding during the period. Common stock equivalents are options granted and shares of restricted

stock issued under our stock awards plans and are calculated under the treasury stock method. Common equivalent shares from unexercised stock options and restricted stock are excluded from the computation when there is a loss as their effect is anti-dilutive, or if the exercise price of such options is greater than the average market price of the stock for the period.

#### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 requires revenue recognition to depict the

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NATUS MEDICAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

transfer of 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. ASU 2014-09 sets forth a new revenue recognition model that requires identifying the contract, identifying the performance obligations, determining the transaction price, allocating the transaction price to performance obligations and recognizing the revenue upon satisfaction of performance obligations.

The original effective date for ASU 2014-09 would have required us to adopt beginning in its first quarter of 2017. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as providing the option to early adopt the standard on the original effective date. Accordingly, we may adopt the standard in either our first quarter of 2017 or our first quarter of 2018. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. We are currently evaluating the timing of its adoption and the impact of adopting the new revenue standard on our consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classifications of Deferred Taxes. This update requires an entity to classify deferred tax liabilities and assets as non-current within a classified statement of financial position. ASU 2015-17 is effective for annual and interim reporting periods beginning after December 15, 2016. This update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. We elected early application prospectively in the beginning of the fourth quarter 2015. Prior periods in the consolidated financial statements were not retrospectively adjusted. As a result, \$14.2 million of current deferred tax assets were reported as non-current deferred tax assets.

## 2—BUSINESS COMBINATIONS

The assets acquired and liabilities assumed at the date of acquisition are recorded in the Consolidated Financial Statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets is recorded as goodwill.

The determination of estimated fair value of acquired assets and liabilities requires management to make significant estimates and assumptions. We determine the fair value by applying established valuation techniques, based on information that management believes to be relevant to this determination. We also utilize independent third parties to assist in the valuation of goodwill, intangible assets, and real estate.

The results of operations of our acquisitions are included in the Consolidated Financial Statements from the date of the acquisition.

### Monarch

We acquired Monarch Medical Diagnostics, LLC ("Monarch") through an asset purchase on November 13, 2015. Monarch's service compliments our Global Neuro-Diagnostics ("GND") acquisition which offers patients a more convenient way to complete routine diagnostic electroencephalography ("EEG") and video electromyography ("EMG") testing which can be performed at the home, hospital or physician's office. The service also provides comprehensive reporting and support to the physician. The cash consideration for Monarch was \$2.7 million. The purchase agreement also included contingent consideration which we paid on January 11, 2016 of \$1.0 million. The total purchase price was allocated to \$112,000 of tangible assets, \$1.2 million of intangible assets with an assigned weighted average life of 5 years being amortized on the straight line method, and \$2.4 million of goodwill. Pro forma financial information for the Monarch acquisition is not presented as it is not considered material.

### Global Neuro-Diagnostics

We acquired GND through an equity purchase on January 23, 2015. GND's service offers patients a more convenient way to complete routine EEG and EMG testing which can be performed at the home, hospital or physician's office. The service also provides comprehensive reporting and support to the physician. The cash consideration for GND was \$11.4 million, which consists primarily of \$1.5 million of tangible assets, \$4.8 million of intangible assets with an assigned weighted average life of 5 years being amortized on the straight line method, and \$8.9 million of goodwill,

offset by \$511,000 of net liabilities. The purchase agreement also included an earn-out condition which was originally estimated to be \$3.2 million. The earn-out condition was subsequently estimated to be \$3.8 million in the fourth quarter of 2015. The earn-out is contingent upon GND achieving certain revenue milestones in 2016 and 2017. Pro forma financial information for the GND acquisition is not presented as it is not considered material.

NicView

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

On January 2, 2015, we purchased the assets of NicView. NicView provides streaming video for families with babies in the neonatal intensive care unit. The cash consideration for NicView was \$1.1 million, of which \$288,000 was allocated to tangible assets and \$2.7 million to goodwill, offset by \$556,000 allocated to net liabilities. The asset purchase agreement included an earn-out condition contingent upon orders received in and installed by February 28, 2016. We estimate this earn-out to be \$1.4 million. Pro forma financial information for the NicView acquisition is not presented as it is not considered material.

Hearing Screening as a Service

In the first quarter of 2014, we entered into two asset purchase agreements for companies in the newborn hearing screening services market for total cash consideration of \$2.6 million. The purchase agreements also included earn-out conditions contingent upon annual revenue growth through 2016. These earn-outs, originally estimated at \$0.8 million, were settled during the second quarter of 2015 for \$0.7 million. Both acquisitions support our entry into this market, which complements our newborn hearing screening device business. This hearing screening services business operates under the name Peloton. Pro forma financial information for these two acquisitions is not presented as it is not considered material.

Grass Technologies

On February 2, 2013, we completed an asset purchase of the Grass Technologies Product Group ("Grass") from Astro-Med Inc. for cash consideration of \$21.0 million. Included in the total cash consideration is an adjustment of \$2.4 million made in the first quarter of 2014 for inventory purchase commitments. The Grass brand offers differentiated neurodiagnostic and monitoring products, including a portfolio of electroencephalography and polysomnography ("PSG") systems for both clinical and research use and related accessories and proprietary electrodes. The acquisition strengthened our existing neurology portfolio and provided new product categories. A total of \$624,000 of direct costs associated with the acquisition was expensed as incurred and reported as a component of general and administrative expenses.

We accounted for the acquisition as a business combination. Under the acquisition method of accounting, the assets acquired and liabilities assumed from the Grass transaction are recorded in the Consolidated Financial Statements at their respective fair values as of the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill. Grass' results of operations are included in our Consolidated Financial Statements since February 2, 2013, the date of the acquisition.

The following table summarizes the purchase price allocation of the fair value of the assets acquired and liabilities assumed at the date of acquisition, as adjusted (in thousands):

|                                 |          |   |
|---------------------------------|----------|---|
| Accounts receivable             | \$4,098  |   |
| Prepaid and other assets        | 33       |   |
| Inventories                     | 547      |   |
| Identifiable intangible assets: |          |   |
| Developed technology            | 2,500    |   |
| Customer-related                | 5,200    |   |
| Trademarks and trade names      | 3,000    |   |
| Other property and equipment    | 237      |   |
| Goodwill                        | 7,014    |   |
| Accounts payable                | (431)    | ) |
| Accrued expenses                | (895)    | ) |
| Deferred revenue                | (348)    | ) |
| Total purchase price            | \$20,955 |   |

Identifiable intangible assets. Intangible assets included in the purchase price allocation consist of: (i) developed technology of \$2.5 million assigned a weighted average economic life of 8 years being amortized on the straight line

method (ii) customer-related intangible assets of \$5.2 million assigned an economic life of 13 years being amortized on the straight line method, and (iii) trademarks and trade names of \$3.0 million that have an indefinite life and are not being amortized but tested for impairment annually. During the fourth quarter of 2014 and 2013 impairment testing, management determined there was an impairment to Grass trademarks and trade names in the amount of \$400,000 and \$600,000, respectively, reducing the indefinite life value to \$2.0 million. All straight-line method of amortization above is based on the expected pattern of future benefits related to those respective intangible assets.

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

Accounts receivable, net of other liabilities, are stated at their historical carrying value, which approximate fair value given the short-term nature of these assets and liabilities. The fair values of the non-financial assets, summarized above, were derived from significant unobservable inputs ("Level 3 inputs") determined by management based on market analysis, income analysis and discounted cash flow model. The fair value of fixed assets ("Level 2 inputs") was determined using market data for similar assets. The fair value of purchased identifiable intangible assets was determined using our discounted cash flow models from income projections prepared by management, using weighted average cost of capital plus up to a 13% risk premium.

Goodwill. Approximately \$7.0 million has been allocated to goodwill. Goodwill is calculated as the difference between the acquisition date fair value of the consideration transferred and the values assigned to the assets acquired and liabilities assumed and represents primarily the expected synergies of integrating the Grass products into our operations. The goodwill is expected to be deductible for tax purposes. In accordance with ASC 350-20, goodwill will not be amortized but instead will be tested for impairment at least annually (more frequently if certain indicators are present). In the event that we determine that the value of the goodwill has become impaired, we will incur an accounting charge for the amount of the impairment.

## Pro forma financial information

The following unaudited pro forma information combines our results of operations for the year ended December 31, 2013 with the results of operations for Grass as if the acquisition had occurred on January 1, 2013.

|                        | 2013      |
|------------------------|-----------|
| Revenue                | \$345,117 |
| Income from operations | \$35,369  |

The unaudited pro forma financial information is provided for comparative purposes only and is not necessarily indicative of what actual results would have been had the acquisitions occurred on the date indicated, nor does it give effect to synergies, cost savings, and other changes expected to result from the acquisitions. Accordingly, the pro forma financial results do not purport to be indicative of results of operations as of the date hereof, for any period ended on the date hereof, or for any other future date or period.

Grass revenue of \$12.8 million and income from operations of \$2.6 million are included in our consolidated statement of income and comprehensive income for the period from February 2, 2013 (acquisition date) to December 31, 2013. For purposes of preparing the unaudited pro forma financial information for the year ended December 31, 2013, Grass' statement of income for the period January 1, 2013 through February 1, 2013 was combined with our consolidated statement of income and comprehensive income for the year ended December 31, 2013.

The unaudited pro forma consolidated results reflect the historical information of Natus and Grass in 2013 adjusted for the following pre-tax amounts:

- Additional amortization expense related to the fair value of identifiable intangible assets acquired (approximately \$59,300 through December 31, 2013);

- Decrease of depreciation expense related to the fair value adjustment to property and equipment acquired (approximately \$14,800 through December 31, 2013); and

- Change in general and administrative expense related to the direct acquisition costs that were recorded in the unaudited pro forma financial (approximately \$624,000 through December 31, 2013);



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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

## 3—INVENTORIES

Inventories consist of (in thousands):

|                                 | December 31, |          |
|---------------------------------|--------------|----------|
|                                 | 2015         | 2014     |
| Raw materials and subassemblies | \$19,041     | \$19,821 |
| Work in process                 | 1,343        | 1,808    |
| Finished goods                  | 36,149       | 26,037   |
| Total Inventories               | 56,533       | 47,666   |
| Less: Non-current Inventories   | (7,961)      | (7,615)  |
| Inventories                     | \$48,572     | \$40,051 |

At December 31, 2015 and 2014, we have classified \$8.0 million and \$7.6 million, respectively, of inventories as non-current. This inventory consists primarily of service components used to repair products held by our customers pursuant to warranty obligations and extended service contracts, including service components for products we are not currently selling. We believe that these inventories will be utilized for their intended purpose.

## 4—PROPERTY AND EQUIPMENT

Property and equipment consist of (in thousands):

|                                    | December 31, |          |
|------------------------------------|--------------|----------|
|                                    | 2015         | 2014     |
| Land                               | \$2,918      | \$3,092  |
| Buildings                          | 5,662        | 6,828    |
| Leasehold improvements             | 2,345        | 2,118    |
| Office furniture and equipment     | 13,866       | 12,945   |
| Computer software and hardware     | 10,488       | 8,715    |
| Demonstration and loaned equipment | 11,216       | 10,929   |
|                                    | 46,495       | 44,627   |
| Accumulated depreciation           | (29,528)     | (26,704) |
| Total                              | \$16,967     | \$17,923 |

Depreciation expense of property and equipment was \$4.2 million, \$4.3 million, and \$4.7 million in the years ending December 31, 2015, 2014 and 2013, respectively.

In the third quarter of 2014 our manufacturing facility in Mundelein, Illinois was listed for sale. This asset was measured at fair value less cost to sell as of September 30, 2014 based on market price and Level 2 inputs and resulted in a \$2.2 million impairment. The impairment was recorded in restructuring expenses and the asset was reclassified from property and equipment, net to other current assets. During the fourth quarter of 2013 we began transitioning the manufacturing operations from the Mundelein facility to our facilities in Seattle, Washington and British Columbia, Canada as well as outsourcing some of the operations in preparation for this sale. This effort is part of Natus' continuing cost reduction and restructuring activities.

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

## 5—GOODWILL

The carrying amount of goodwill and the changes in those balances are as follows (in thousands):

|  |           |
|--|-----------|
| As of December 31, 2013                      | \$97,238  |
| Acquisitions/Purchase Accounting Adjustments | 4,002     |
| Foreign currency translation                 | (4,924 )  |
| As of December 31, 2014                      | \$96,316  |
| Acquisitions/Purchase Accounting Adjustments | 13,547    |
| Foreign currency translation                 | (2,397 )  |
| As of December 31, 2015                      | \$107,466 |

## 6—INTANGIBLE ASSETS

The following table summarizes the components of gross and net intangible asset balances (in thousands):

|   | December 31, 2015           |                           |                             |                   | December 31, 2014           |                           |                             |                   |
|---|-----------------------------|---------------------------|-----------------------------|-------------------|-----------------------------|---------------------------|-----------------------------|-------------------|
|   | Gross<br>Carrying<br>Amount | Accumulated<br>Impairment | Accumulated<br>Amortization | Net Book<br>Value | Gross<br>Carrying<br>Amount | Accumulated<br>Impairment | Accumulated<br>Amortization | Net Book<br>Value |
| Intangible<br>assets with<br>definite lives:      |                             |                           |                             |                   |                             |                           |                             |                   |
| Technology  | \$63,668                    | —                         | \$ (31,600 )                | \$32,068          | \$64,376                    | —                         | \$ (28,195 )                | \$36,181          |
| Customer<br>related                               | 35,529                      | —                         | (14,352 )                   | 21,177            | 31,189                      | —                         | (11,786 )                   | 19,403            |
| Trade names                                       | 31,837                      | (3,340 )                  | (3,052 )                    | 25,445            | —                           | —                         | —                           | —                 |
| Internally<br>developed<br>software               | 15,513                      | —                         | (8,155 )                    | 7,358             | 14,109                      | —                         | (6,511 )                    | 7,598             |
| Patents   | 2,663                       | —                         | (2,175 )                    | 488               | 2,794                       | —                         | (2,154 )                    | 640               |
| Backlog   | 717                         | —                         | (717 )                      | —                 | 719                         | —                         | (719 )                      | —                 |
| Definite-lived<br>intangible<br>assets            | 149,927                     | (3,340 )                  | (60,051 )                   | 86,536            | 113,187                     | —                         | (49,365 )                   | 63,822            |
| Intangible<br>assets with<br>indefinite<br>lives: |                             |                           |                             |                   |                             |                           |                             |                   |
| Trade names                                       | —                           | —                         | —                           | —                 | 32,443                      | (3,504 )                  | —                           | 28,939            |
| Total<br>intangible<br>assets                     | 149,927                     | (3,340 )                  | (60,051 )                   | 86,536            | 145,630                     | (3,504 )                  | (49,365 )                   | 92,761            |

Finite lived intangible assets are amortized over their useful lives, which are 10 to 15 years for patents, 5 to 10 years for technology, 4 to 16 years for customer-related intangibles, 7 years for tradenames, and 4 to 10 years for internally developed software.

Internally developed software consists of \$13.3 million relating to costs incurred for development of internal use computer software and \$2.2 million for development of software to be sold.

During the year ended December 31, 2014 we recorded a charge of \$0.6 million related to the impairment of the Grass trade name. This impairment is a result of deterioration of expected future cash flows. Impairments are determined by

performing a discounted cash flow analyses on our intangibles assets. These charges were recorded in Intangible amortization.

Amortization expense related to intangible assets with finite lives was as follows (in thousands):

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

|   | Years Ended December 31, |         |          |
|---|--------------------------|---------|----------|
|   | 2015                     | 2014    | 2013     |
| Technology  | \$3,916                  | \$3,993 | \$4,355  |
| Customer related  | 2,938                    | 1,892   | 2,644    |
| Trade names   | 3,159                    | —       | —        |
| Internally developed software   | 1,620                    | 1,434   | 1,034    |
| Patents   | 112                      | 113     | 121      |
| Total amortization  | \$11,745                 | \$7,432 | \$8,154  |
| Expected annual amortization expense related to amortizable intangible assets is as follows (in thousands): |                          |         |          |
| 2016  |                          |         | \$12,501 |
| 2017  |                          |         | 12,203   |
| 2018  |                          |         | 11,980   |
| 2019  |                          |         | 10,860   |
| 2020  |                          |         | 8,766    |
| Thereafter  |                          |         | 30,226   |
| Total expected amortization expense   |                          |         | \$86,536 |

During the second quarter of 2015 we initiated a strategy to increase the brand strength of Natus by replacing acquired product trade names with Natus branded products over time. The implementation of this strategy places definite expected future lives on our acquired trade names which previously had indefinite lives. We assigned these trade names lives of seven years based on the timeline of our branding strategy. We will continue to assess the lives of these assets based on the timing and execution of this strategy. Amortization expense for trade names is recorded as a component of operating expense. For the year ended December 31, 2015, this change increased our amortization expense and decreased pre-tax income by approximately \$3.0 million, decreased net income by approximately \$2.1 million, and decreased diluted earnings per share by \$0.06 per share.

## 7—ACCRUED LIABILITIES

Accrued liabilities consist of (in thousands):

|   | December 31, |          |
|---|--------------|----------|
|   | 2015         | 2014     |
| Compensation and related benefits       | \$16,752     | \$16,075 |
| Accrued federal, state, and local taxes | 4,707        | 9,213    |
| Warranty reserve                        | 10,386       | 2,753    |
| Accrued professional fees               | 520          | 1,027    |
| Contingent consideration                | 6,209        | 812      |
| Other                                   | 3,563        | 6,144    |
| Total                                   | \$42,137     | \$36,024 |

## 8—LONG-TERM OTHER LIABILITIES

Long-term other liabilities consist of (in thousands):

|                              | December 31, |         |
|------------------------------|--------------|---------|
|                              | 2015         | 2014    |
| Contingent tax obligations   | \$6,376      | \$3,299 |
| Non-current deferred revenue | 1,401        | 1,537   |
| Other                        | 4            | 23      |
| Total                        | \$7,781      | \$4,859 |



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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

## 9—RESERVE FOR PRODUCT WARRANTIES

We provide a warranty with our products that is generally one year in length and in some cases, regulations may require us to provide repair or remediation beyond our typical warranty period. If any of our products contain defects, we may be required to incur additional repair and remediation costs. Service for domestic customers is provided by Company-owned service centers that perform all service, repair and calibration services. Service for international customers is provided by a combination of Company-owned facilities and vendors on a contract basis.

A warranty reserve is included in accrued liabilities for the expected future costs of servicing products. Additions to the reserve are based on management's best estimate of probable liability. We consider a combination of factors including material and labor costs, regulatory requirements, and other judgments in determining the amount of reserve. The reserve is reduced as costs are incurred to honor existing warranty and regulatory obligations.

As of December 31, 2015 we have accrued \$6.6 million to bring certain NeoBLUE® phototherapy products into U.S. regulatory compliance. Our estimate of the costs associated with bringing the NeoBLUE® phototherapy products into compliance is primarily based upon the number of units outstanding that may require the repair, costs associated with shipping and repairing the product, and the assumption that the FDA will approve our plan for compliance. We expect that costs associated with bringing the products back into compliance will not be incurred until the third quarter of 2016.

The details of activity in the warranty reserve are as follows (in thousands):

|                   | Balance at<br>Beginning<br>of Period | Assumed<br>Through<br>Acquisitions | Additions<br>Charged to<br>Expense | Reductions | Balance<br>at End<br>of Period |
|-------------------|--------------------------------------|------------------------------------|------------------------------------|------------|--------------------------------|
| December 31, 2015 | \$2,753                              | \$—                                | \$10,729                           | \$(3,096)  | ) \$10,386                     |
| December 31, 2014 | \$3,143                              | \$—                                | \$2,306                            | \$(2,696)  | ) \$2,753                      |
| December 31, 2013 | \$2,260                              | \$191                              | \$1,938                            | \$(1,246)  | ) \$3,143                      |

The estimates we use in projecting future product warranty costs may prove to be incorrect. Any future determination that our product warranty reserves are understated could result in increases to our cost of sales and reductions in our operating profits and results of operations.

## 10—STOCKHOLDERS' EQUITY

Common Stock—We have 120,000,000 shares of common stock authorized at a par value of \$0.001 per share.

Preferred Stock—We have 10,000,000 shares of preferred stock authorized at a par value of \$0.001 per share. In accordance with the terms of the amended and restated certificate of incorporation, the Board of Directors is authorized to provide for the issuance of one or more series of preferred stock, including increases or decreases to the series. The Board of Directors has the authority to set the rights, preferences, and terms of such shares. As of December 31, 2015, no shares of preferred stock were issued and outstanding.

## 11—Earnings Per Share

The components of basic and diluted EPS are as follows (in thousands):

|   | December 31, |          |          |
|---|--------------|----------|----------|
|   | 2015         | 2014     | 2013     |
| Net income                                      | \$37,924     | \$32,478 | \$23,147 |
| Weighted average common shares                  | 32,348       | 31,499   | 29,993   |
| Dilutive effect of stock based awards           | 893          | 1,069    | 828      |
| Diluted Shares                                  | 33,241       | 32,568   | 30,821   |
| Basic earnings per share                        | \$1.17       | \$1.03   | \$0.77   |
| Diluted earnings per share                      | \$1.14       | \$1.00   | \$0.75   |
| Shares excluded from calculation of diluted EPS | —            | 239      | 1,413    |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

## 12—SHARE-BASED COMPENSATION

Share-Based Compensation Expense—We account for share-based compensation in accordance with ASC Topic 718, Compensation—Stock Compensation. Share-based compensation was recognized as follows in the consolidated statement of income (in thousands):

|                            | December 31, |        |        |
|----------------------------|--------------|--------|--------|
|                            | 2015         | 2014   | 2013   |
| Cost of revenue            | \$ 156       | \$ 143 | \$ 120 |
| Marketing and selling      | 808          | 977    | 816    |
| Research and development   | 1,264        | 664    | 527    |
| General and administrative | 4,725        | 4,278  | 4,456  |
| Total expense              | 6,953        | 6,062  | 5,919  |

Stock Awards Plans—Our 2011 Stock Awards Plan (the “Plan”) provides for the granting of the following:

- Incentive stock options to employees;
- Non-statutory stock options to employees, directors and consultants;
- Restricted stock awards and restricted stock units;
- Stock bonuses; and
- Stock appreciation rights.

As of December 31, 2015, there were 1,297,008 shares available for future awards under the plan.

Under the Plan, stock options may be issued at not less than the fair market value of the common stock on the date of grant, as determined by the Board of Directors. Options issued under the Plan become exercisable as determined by the Board of Directors and expire no more than six years after the date of grant. Most options vest ratably over four years.

Stock Option Activity—Stock option activity under our stock awards plans for the year ended December 31, 2015 and 2014 is summarized as follows:

|   | Number of<br>Shares | Weighted<br>Average<br>Exercise Price |
|---|---------------------|---------------------------------------|
| Outstanding, December 31, 2013 (1,843,779 shares exercisable at a weighted average exercise price of \$12.68 per share) | 2,789,723           | \$ 12.90                              |
| Granted   | 244,500             | \$ 22.60                              |
| Exercised   | (1,242,679 )        | \$ 12.14                              |
| Cancelled   | (34,942 )           | \$ 15.29                              |
| Outstanding, December 31, 2014 (1,051,616 shares exercisable at a weighted average exercise price of \$14.13 per share) | 1,756,602           | \$ 14.74                              |
| Granted   | —                   | \$ —                                  |
| Exercised   | (631,663 )          | \$ 14.26                              |
| Cancelled   | (19,757 )           | \$ 11.99                              |
| Outstanding, December 31, 2015 (737,032 shares exercisable at a weighted average exercise price of \$14.40 per share)   | 1,105,182           | \$ 15.07                              |

As of December 31, 2015, unrecognized compensation related to the unvested portion of our stock options was approximately \$1.3 million, which is expected to be recognized over a weighted average period of 1.5 years. The intrinsic value of options exercised, representing the difference between the closing stock price of our common stock on the date of the exercise and the exercise price, in the years ended December 31, 2015, 2014 and 2013 was \$17.7 million, \$20.6 million, and \$9.9 million, respectively.

As of December 31, 2015, there were: (i) 1,071,852 options vested and expected to vest with a weighted average exercise price of \$14.99, an intrinsic value of \$35.4 million, and a weighted average remaining contractual term of 2.8



years; and (ii) 737,032

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

options exercisable with a weighted average exercise price of \$14.40, an intrinsic value of \$24.8 million, and a weighted average remaining contractual term of 2.6 years.

Black-Scholes Inputs—The fair value of option grants was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

|  | Years Ended December 31, |        |  |   |
|--|--------------------------|--------|--|---|
|  | 2014                     | 2013   |  |   |
| Weighted-average fair value of options granted | \$7.25                   | \$4.24 |  |   |
| Expected life in years                         | 4.0                      | 4.1    |  |   |
| Risk-free interest rate                        | 1.4                      | % 1.2  |  | % |
| Expected volatility                            | 39                       | % 37   |  | % |
| Dividend yield                                 | None                     | None   |  |   |

For the year ended December 31, 2015, no assumptions are disclosed as there were no options grants during the year.

The expected life of options is based primarily on historical share option exercise experience of our employees for options granted by the Company. All options are treated as a single group in the determination of expected life, as we do not currently expect substantially different exercise or post-vesting termination behavior among our employee population. The risk-free interest rate is based on the U.S. Treasury yield for a term consistent with the expected life of the awards in effect at the time of grant. Expected volatility is based primarily on historical volatility data of our common stock. We have no history or expectation of paying dividends on our common stock.

Share-based compensation expense associated with options is based on awards ultimately expected to vest. At the time of an option grant, we estimate the expected future rate of forfeitures based on historical experience. These estimates are revised, if necessary, in subsequent periods if actual forfeiture rates differ from those estimates. If the actual forfeiture rate is lower than estimated we will record additional expense and if the actual forfeiture is higher than estimated we will record a recovery of prior expense.

Restricted Stock Awards Activity—The following table summarizes the activity for restricted stock awards during the years ended December 31, 2015 and 2014:

|                               | Shares    | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|-------------------------------|-----------|--|
| Unvested at December 31, 2013 | 625,330   | \$13.28  |
| Granted                       | 197,850   | \$22.68  |
| Vested                        | (223,811) | ) \$13.03  |
| Forfeited                     | (15,985)  | ) \$14.73  |
| Unvested at December 31, 2014 | 583,384   | \$16.50  |
| Granted                       | 211,080   | \$16.52  |
| Vested                        | (244,896) | ) \$36.38  |
| Forfeited                     | (14,360)  | ) \$15.19  |
| Unvested at December 31, 2015 | 535,208   | \$17.42  |

As of December 31, 2015, unrecognized compensation related to the unvested portion of our stock awards was approximately \$6.1 million, which is expected to be recognized over a weighted average period of 2.2 years. The fair market value of outstanding restricted stock awards at December 31, 2015 was \$25.9 million. The weighted average remaining recognition period for unvested restricted stock awards at December 31, 2015 was 1.9 years.

Restricted Stock Units Activity—The following table summarizes restricted stock units activity for the years ended December 31, 2015 and 2014:

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

|                               | 2015     | 2014     |
|-------------------------------|----------|----------|
| Beginning outstanding balance | 52,325   | 47,391   |
| Awarded                       | 15,530   | 20,600   |
| Released                      | (21,619) | (13,121) |
| Forfeited                     | (753)    | (2,545)  |
| Ending outstanding balance    | 45,483   | 52,325   |

As of December 31, 2015, unrecognized compensation related to the unvested portion of our stock units was approximately \$473,000, which is expected to be recognized over a weighted average period of 1.6 years. The aggregate intrinsic value of outstanding restricted stock units at December 31, 2015 was \$2.0 million. The weighted average remaining recognition period for unvested restricted stock units at December 31, 2015 was 1.4 years. For the restricted stock awards and restricted stock units that vested during the years ended December 31, 2015, 2014, and 2013, the total intrinsic value was \$11.2 million, \$6.4 million, and \$3.2 million, respectively.

Employee Stock Purchase Plan—Under our 2011 Employee Stock Purchase Plan (the “ESPP”), our U.S. employees can elect to have salary withholdings of up to 15% of their eligible compensation to a maximum of \$10,625 per offering period, to purchase shares of common stock on April 30 and October 31 of each year. The purchase price for shares acquired under the ESPP is 85% of the fair market value on the last day of the offering period. As of December 31, 2015, there were 211,255 shares reserved for future issuance under the ESPP.

Because the ESPP does not have a “look back” feature, the compensation expense associated with the Plan is not measured by the use of the Black-Scholes pricing model, but rather by measuring the difference between the fair market value of our common stock on the last day of the offering period and the purchase price for the offering period, which is 85% of the fair market value. Compensation expense associated with the ESPP for the years ended December 31, 2015, 2014 and 2013, respectively, was \$221,000, \$198,000, and \$159,000.

**13—RESTRUCTURING RESERVE**

We have historically incurred an ongoing level of restructuring-type activities to maintain a competitive cost structure, including manufacturing and workforce optimization resulting from acquisitions.

The balance of the restructuring reserve is included in accrued liabilities on the accompanying consolidated balance sheets. Employee termination benefits are included as a part of restructuring expenses.

Activity in the restructuring reserves for these plans for the years ended December 31, 2015, 2014 and 2013 is as follows (in thousands):

|                                 | Personnel<br>Related | Facility<br>Related | Other     | Total     |
|---------------------------------|----------------------|---------------------|-----------|-----------|
| Balance as of December 31, 2012 | \$2,745              | —                   | —         | \$2,745   |
| Additions                       | 4,218                | 504                 | 1,363     | 6,085     |
| Reversals                       | (1,357)              | ) —                 | —         | (1,357)   |
| Payments                        | (5,271)              | ) (504)             | ) (1,363) | ) (7,138) |
| Balance as of December 31, 2013 | 335                  | —                   | —         | 335       |
| Additions                       | 1,209                | 680                 | —         | 1,889     |
| Reversals                       | (52)                 | ) —                 | —         | (52)      |
| Payments                        | (1,124)              | ) (680)             | ) —       | ) (1,804) |
| Balance as of December 31, 2014 | 368                  | —                   | —         | 368       |
| Additions                       | 1,905                | 156                 | —         | 2,061     |
| Reversals                       | (124)                | ) —                 | —         | (124)     |
| Payments                        | (473)                | ) (156)             | ) —       | ) (629)   |
| Balance as of December 31, 2015 | \$1,676              | —                   | —         | \$1,676   |



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Years Ended December 31, 2015, 2014 and 2013

## 14—OTHER INCOME (EXPENSE), NET

Other income (expense), net consists of (in thousands):

|                                   | Years Ended December 31, |         |            |
|-----------------------------------|--------------------------|---------|------------|
|                                   | 2015                     | 2014    | 2013       |
| Interest income                   | \$27                     | \$119   | \$32       |
| Interest expense                  | (352)                    | ) (438  | ) (1,675 ) |
| Foreign currency loss             | (1,415                   | ) (37   | ) (1,412 ) |
| Other                             | 676                      | 514     | 339        |
| Total other income (expense), net | \$(1,064                 | ) \$158 | \$(2,716 ) |

## 15—INCOME TAXES

Income before provision for income tax is as follows (in thousands):

|  | Years Ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2015                     | 2014     | 2013     |
| U.S.                                   | \$20,507                 | \$16,621 | \$13,200 |
| Foreign                                | 31,902                   | 29,388   | 18,744   |
| Income before provision for income tax | \$52,409                 | \$46,009 | \$31,944 |

The components of income tax expense for the years ended December 31, 2015, 2014 and 2013 (in thousands):

|                                      | Years Ended December 31, |          |            |
|--------------------------------------|--------------------------|----------|------------|
|                                      | 2015                     | 2014     | 2013       |
| Current                              |                          |          |            |
| U.S. Federal                         | \$13,497                 | \$6,514  | \$5,338    |
| U.S. State and local                 | 1,984                    | 1,082    | 723        |
| Non-U.S.                             | 2,239                    | 6,874    | 1,708      |
| Total current tax expense            | 17,720                   | 14,470   | 7,769      |
| Deferred                             |                          |          |            |
| U.S. Federal                         | (3,410                   | ) (728   | ) (1,042 ) |
| U.S. State and local                 | (385                     | ) (37    | ) (85 )    |
| Non-U.S.                             | 560                      | (174     | ) 2,155    |
| Total deferred tax expense (benefit) | (3,235                   | ) (939   | ) 1,028    |
| Total income tax expense             | \$14,485                 | \$13,531 | \$8,797    |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets and liabilities as of December 31, 2015 and 2014 are as follows (in thousands):

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

|   | December 31,<br>2015 | 2014     |
|---|----------------------|----------|
| Deferred tax assets:                            |                      |          |
| Net operating loss carryforwards                | \$5,174              | \$4,153  |
| Credit carryforwards                            | 2,078                | 2,191    |
| Accruals deductible in different periods        | 18,721               | 15,666   |
| Employee benefits                               | 2,081                | 2,864    |
| Total deferred tax assets                       | 28,054               | 24,874   |
| Valuation allowance                             | (3,972)              | (3,151)  |
| Total net deferred tax assets                   | \$24,082             | \$21,723 |
| Deferred tax liabilities:                       |                      |          |
| Basis difference in fixed and intangible assets | (15,197)             | (17,169) |
| Total deferred tax liabilities                  | (15,197)             | (17,169) |
| Total net deferred tax assets                   | \$8,885              | \$4,554  |

The income tax expense in the accompanying statements of income differs from the provision calculated by applying the U.S. federal statutory income tax rate of 35% in 2015, 2014, and 2013 to income before taxes due to the following:

|   | Years Ended December 31, |          |          |
|---|--------------------------|----------|----------|
|   | 2015                     | 2014     | 2013     |
| Federal statutory tax expense                         | \$18,343                 | \$16,103 | \$11,180 |
| State tax expense                                     | 1,249                    | 892      | 352      |
| Foreign taxes at rates less than U.S. rates           | (5,129)                  | (3,097)  | (1,496)  |
| Stock compensation expense on incentive stock options | 204                      | 93       | 49       |
| Tax credits   | (935)                    | (862)    | (834)    |
| Uncertain tax position                                | 1,388                    | 1,163    | 1,029    |
| Lapse of statute                                      | (784)                    | (652)    | (918)    |
| Change of valuation allowance on foreign tax credit   | —                        | (491)    | —        |
| Other   | 149                      | 382      | (565)    |
| Total expense   | \$14,485                 | \$13,531 | \$8,797  |

At December 31, 2015, we had no U.S. federal and state net operating loss carryforwards because all operating losses were utilized during the fiscal year. We had \$1.7 million of U.S. foreign tax credit carryforwards that can be used to offset future U.S. tax liabilities related to foreign source taxable income. The foreign tax credits will start to expire in 2016, and were originally generated in 2006.

At December 31, 2015, certain foreign subsidiaries had tax net operating loss carryforwards as follows: \$2.0 million in France, \$393,000 in Germany, \$654,000 in Canada, \$1.4 million in Denmark, and \$753,000 in United Kingdom. These foreign net operating loss carryforwards, if not utilized to offset taxable income in future periods, will expire in various amounts beginning in 2028.

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Accordingly, valuation allowances of \$4.0 million and \$3.2 million were recorded during the years ended December 31, 2015 and 2014, respectively. The increase of \$800,000 of valuation allowance was primarily due to a reduction in our ability to realize the tax benefit of our net operating losses in the United Kingdom. Our ability to realize the tax benefit of foreign tax losses is primarily dependent on our ability to generate sufficient foreign taxable income in the future periods. Although realization is not assured, we weighed the aggregate effect of all positive evidence and negative evidence including the applicability of ongoing tax planning strategies and history of earnings to estimate future taxable income level of each jurisdiction. In the event we were to determine that we would not be able to realize all or a portion of our deferred tax assets in the future, we would reduce such amounts

through an increase to tax expense in the period in which that determination is made or when tax law changes are enacted. Conversely, if we were to determine that we would be able to realize our deferred tax assets in the future in excess of the net carrying amounts, we would decrease the recorded valuation allowance through a decrease to tax expense in the period in which that determination is made.

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We receive tax deductions from the gains realized by employees on the exercise of certain non-qualified stock options for which the benefit is recognized as a component of stockholders' equity. As of December 31, 2015, we recorded approximately \$7.4 million change to stockholder's equity related to exercises or sales of certain stock options by employees. In addition, we recorded a shortfall of \$263,000 to stockholder's equity related to the stock windfall pool as of December 31, 2015.

We have not provided for U.S. federal income and foreign withholding taxes on the majority of undistributed earnings from non-U.S. operations as of December 31, 2015 because such earnings are intended to be reinvested indefinitely outside of the U.S. As of December 31, 2015, the U.S. income taxes and foreign withholding taxes were not provided for on a cumulative total of approximately \$81.3 million of the undistributed earnings for our Canada and certain European subsidiaries. We intend to reinvest these earnings in our foreign subsidiaries in these regions for foreign acquisitions and purchase various intangible assets among our foreign subsidiaries. If these earnings were distributed to the U.S. in the form of dividends or otherwise, we would be subject to additional U.S. income taxes and foreign withholding taxes. As of December 31, 2015, the tax impact of undistributed earnings from non-U.S. operations has not been estimated as the determination is not practicable. Our foreign subsidiaries held \$60.2 million cash and short term investments out of the total cash and short term investments of \$82.5 million. If the foreign earnings were repatriated, the cash and short term investments available for other foreign financing activities will be reduced by the foreign taxes paid on the repatriation of earnings in these regions.

Uncertain Tax Positions

A reconciliation of the beginning and ending amount of unrecognized tax benefits (excluding interest and penalties) is as follows (in thousands):

|   |         |   |
|---|---------|---|
| Balance at January 1, 2013                              | 2,716   |   |
| Increases for tax positions related to prior years      | 1,376   |   |
| Increases for tax positions related to the current year | 213     |   |
| Lapse of statutes of limitations                        | (918)   | ) |
| Balance at January 1, 2014                              | \$3,387 |   |
| Increases for tax positions related to prior years      | 493     |   |
| Increases for tax positions related to the current year | 73      |   |
| Lapse of statutes of limitations                        | (558)   | ) |
| Balance at January 1, 2015                              | \$3,395 |   |
| Increases for tax positions related to prior years      | 281     |   |
| Increases for tax positions related to the current year | 3,302   |   |
| Lapse of statutes of limitations                        | (664)   | ) |
| Balance at December 31, 2015                            | \$6,314 |   |

For the year ended December 31, 2015, our unrecognized tax benefits increased by \$2.9 million and only \$509,000 was recorded in our income tax provision as the remaining balance was recorded in our prepaid expense, in accordance with ASC 710-10-25-3(e) and ASC 810-10-45-8.

The unrecognized tax benefits for the tax years ended December 31, 2015, 2014 and 2013 were \$6.3 million, \$3.4 million and \$3.4 million, respectively which include \$2.4 million, \$2.0 million and \$2.2 million, respectively that would impact our effective tax rate if recognized.

We expect a range from approximately zero to \$460,000 of unrecognized tax benefit that will impact the effective tax rate in the next 12 months due to the lapse of statute of limitations provided that no taxing authority conducts a new examination.

At December 31, 2015, 2014 and 2013, we had cumulatively accrued approximately \$397,000, \$288,000, and \$300,000 for estimated interest and penalties related to uncertain tax positions. We record interest and penalties related to unrecognized tax positions as a component of income tax expense, which totaled approximately \$109,000, \$(12,000), and \$(8,000) for the years ended December 31, 2015, 2014, and 2013, respectively.

We are currently unaware of any uncertain tax positions that could result in significant additional payments, accruals, or other material deviation in this estimate over the next 12 months.

Our tax returns remain open to examination as follows: U.S. federal, 2012 through 2015; U.S. states, generally 2011 through 2015; significant foreign jurisdictions, generally 2011 through 2015.

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NATUS MEDICAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

16—EMPLOYEE BENEFIT PLAN

We offer pre-tax and after-tax 401(k) savings plan options under which eligible U.S. employees may elect to have a portion of their salary deferred and contributed to the plan. Employer matching contributions are determined by management and are discretionary. Employer matching contributions were approximately \$1.3 million, \$1.2 million, and \$1.3 million respectively, in the years ended December 31, 2015, 2014, and 2013. For new hires, employer contributions vest ratably over the first two years of employment.

17—SEGMENT, CUSTOMER, AND GEOGRAPHIC INFORMATION

We operate in one reportable segment, which we have presented as the aggregation of our Neurology and Newborn Care operating segments. Through our one reportable segment we are organized on the basis of the healthcare products and services we provide which are used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders. Our end-user customer base includes hospitals, clinics, laboratories, physicians, nurses, audiologists, and governmental agencies. Most of our international sales are to distributors who resell our products to end users or sub-distributors. Our foreign countries' revenue is determined based on the customer's billing address.

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

Revenue and long-lived asset information by geographic region is as follows (in thousands):

|                               | Years Ended December 31, |           |           |
|-------------------------------|--------------------------|-----------|-----------|
|                               | 2015                     | 2014      | 2013      |
| Revenue:                      |                          |           |           |
| United States                 | \$242,050                | \$215,543 | \$199,591 |
| Foreign countries             | 133,815                  | 140,291   | 144,521   |
|                               | \$375,865                | \$355,834 | \$344,112 |
| Revenue by Operating Segment: |                          |           |           |
| Neurology                     |                          |           |           |
| Devices and Systems           | \$168,776                | \$173,006 | \$162,607 |
| Supplies                      | 60,205                   | 59,666    | 61,065    |
| Services                      | 8,320                    | —         | —         |
| Total Neurology Revenue       | \$237,301                | \$232,672 | \$223,672 |
| Newborn Care                  |                          |           |           |
| Devices and Systems           | \$72,669                 | \$67,354  | \$68,588  |
| Supplies                      | 49,982                   | 48,697    | 47,033    |
| Services                      | 15,913                   | 7,111     | 4,819     |
| Total Newborn Care Revenue    | \$138,564                | \$123,162 | \$120,440 |
| Total Revenue                 | \$375,865                | \$355,834 | \$344,112 |
| Property and equipment, net:  |                          |           |           |
| United States                 | \$6,664                  | \$5,782   |           |
| Canada                        | 5,165                    | 5,538     |           |
| Ireland                       | 1,651                    | 1,656     |           |
| Argentina                     | 2,361                    | 3,692     |           |
| Other foreign countries       | 1,126                    | 1,255     |           |
|                               | \$16,967                 | \$17,923  |           |

During the years ended December 31, 2015, 2014 and 2013, no single customer or foreign country contributed to more than 10% of revenue.

**18—DEBT AND CREDIT ARRANGEMENTS**

At December 31, 2015 we have a Credit Agreement with Citibank, National Association (“Citibank”). Pursuant to the terms of the Credit Agreement, Citibank agrees, on a non-committed basis, to make loans to us from time to time, not to exceed at any time the aggregate principal amount of \$25 million. The proceeds under the Revolving Line of Credit shall be used for working capital and general corporate purposes. The Credit Agreement contains covenants, including covenants relating to maintenance of books and records, financial reporting and notification, compliance with laws, maintenance of properties and insurance, and limitations on guaranties, investments, issuance of debt, lease obligations and capital expenditures. The Credit Agreement provides for events of default, including failure to pay any principal or interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. Concurrent with the execution of the Credit Agreement, we have exited an existing and previously disclosed credit agreement between us and Wells Fargo, N.A. We have no other significant credit facilities.

As of December 31, 2015, there were no amounts outstanding under the Citibank credit agreement.

**19—COMMITMENTS AND CONTINGENCIES**

**Leases—**We have entered into noncancelable operating leases for some of our facilities including related office equipment located in the U.S. and Europe through 2024. Minimum lease payments under noncancelable operating

leases as of December 31, 2015 are as follows (in thousands):

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|                              | Operating<br>Leases |
|------------------------------|---------------------|
| Year Ending December 31,     |                     |
| 2016                         | \$3,909             |
| 2017                         | 3,590               |
| 2018                         | 2,865               |
| 2019                         | 2,798               |
| 2020                         | 2,465               |
| Thereafter                   | 4,979               |
| Total minimum lease payments | \$20,606            |

Rent expense, which is recorded on the straight-line method from commencement over the period of the lease, totaled \$4.4 million, \$4.3 million and \$3.9 million in 2015, 2014, and 2013, respectively.

Purchase commitments—We had various purchase obligations for goods or services totaling \$40.3 million at December 31, 2015, which are expected to be paid within the next year.

Indemnifications—Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. We have a director and officer liability insurance policy that limits our exposure under these indemnifications and enables us to recover a portion of any future loss arising out of them. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. We have determined that these agreements fall within the scope of ASC 460, Guarantees. In some cases we have obtained liability insurance providing coverage that limits its exposure for these other indemnified matters. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these indemnification agreements is minimal and have not recorded a liability for these agreements as of December 31, 2015.

Legal matters—We may from time to time become a party to various legal proceedings or claims that arise in the ordinary course of business. We do not believe that any current legal or administrative proceedings are likely to have a material effect on our business, financial condition, or results of operations.

## 20—FAIR VALUE MEASUREMENTS

ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Fair value is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes the following three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value:

Level 1—Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

We do not have any financial assets or liabilities measured at fair value on a recurring basis.

The following financial instruments are not measured at fair value on our consolidated balance sheet as of December 31, 2015 and 2014, but require disclosure of their fair values: cash and cash equivalents, accounts receivable, and accounts payable. The carrying value of these financial instruments approximates fair values because of their relatively short maturity.

During the third quarter of 2014, we listed our facility in Mundelein, Illinois for sale. This asset was measured at fair value less cost to sell as of September 30, 2014 based on market price and Level 2 inputs. The book value of this asset on June 30, 2014 was \$3.6 million. We expensed \$2.2 million during the third quarter of 2014 for this impairment. As of December 31, 2015 we are carrying the asset as held for sale its fair value of \$1.4 million.

For the years ended December 31, 2014 and 2013 we recorded charges of \$0.6 million and \$1.5 million, respectively, related to impairment of trademarks and trade names. We measure these non-financial assets at fair value on a nonrecurring basis subsequent

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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

to their initial recognition. The fair value of these non-financial assets was measured using Level 3 inputs. See Note 6—Intangible Assets.

We also have contingent consideration associated with earn-outs from acquisitions. Contingent consideration liabilities are classified as Level 3 liabilities, as we use unobservable inputs to value them, which is a probability-based income approach. Contingent considerations are classified as accrued liabilities on our consolidated balance sheets. Subsequent changes in the fair value of contingent consideration liabilities are recorded within our income statement as an operating expense.

|                          | December 31,<br>2014 | Additions | Payments | Adjustments | December 31,<br>2015 |
|--------------------------|----------------------|-----------|----------|-------------|----------------------|
| Liabilities:             |                      |           |          |             |                      |
| Contingent consideration | \$812                | \$6,209   | \$(664 ) | \$(148 )    | \$6,209              |
| Total                    | \$812                | \$6,209   | \$(664 ) | \$(148 )    | \$6,209              |

The significant unobservable inputs used in the fair value measurement of contingent consideration related to the acquisitions are annualized revenue forecasts developed by us considering the probability of achievement of those revenue forecasts. Significant increases (decreases) in these unobservable inputs in isolation would result in a significantly lower (higher) fair value measurement.

## 21—IMMATERIAL CORRECTIONS TO PRIOR PERIOD FINANCIAL STATEMENTS

Subsequent to the issuance of our consolidated financial statements for the year ended December 31, 2013 we discovered an error related to the amount of manufacturing labor and overhead applied to inventory. As a result, certain previously reported amounts included in the accompanying consolidated financial statements for 2013 were revised in our consolidated financial statements for the year ended December 31, 2014 to reflect the correction of this error. We believe the effects of the errors are not material to our consolidated financial statements.

A summary of the effects of the correction of this error on our consolidated financial statements as of and for the years ended December 31, 2013 are presented in the table below (in thousands, except per share data):



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## NATUS MEDICAL INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

Years Ended December 31, 2015, 2014 and 2013

|   | 2013<br>Previously<br>Reported | Revised    |
|---|--------------------------------|------------|
| Statements of Operations  |                                |            |
| Cost of revenue (1)   | \$ 142,081                     | \$ 141,700 |
| Gross profit  | 202,031                        | 202,412    |
| Income from operations  | 34,279                         | 34,660     |
| Income before provision for income tax  | 31,563                         | 31,944     |
| U.S. (Note 15)  | 13,108                         | 13,200     |
| Foreign (Note 15)   | 18,455                         | 18,744     |
| Provision for income tax expense  | 8,685                          | 8,797      |
| Current U.S. Federal (Note 15)  | 5,302                          | 5,338      |
| Current Non-U.S. (Note 15)  | 1,632                          | 1,708      |
| Federal statutory tax expense (Note 15)   | 11,047                         | 11,180     |
| Uncertain tax position (Note 15)  | 917                            | 1,029      |
| Other (Note 15)   | (438                           | ) (565     |
| Net income  | 22,878                         | 23,147     |
| Comprehensive income  | 20,905                         | 21,175     |
| Net income per share, basic   | \$0.76                         | \$0.77     |
| Net income per share, diluted   | \$0.74                         | \$0.75     |
| Statements of Cash Flows  |                                |            |
| Net income  | \$22,878                       | \$23,147   |
| Changes in operating assets and liabilities, net of assets and liabilities<br>acquired in acquisitions: |                                |            |
| Inventories   | (2,298                         | ) (2,679   |
| Other Assets  | (6,899                         | ) (6,899   |
| Accrued liabilities   | (5,413                         | ) (5,301   |
| Net cash provided by operating activities   | 36,797                         | 36,797     |
| Statement of Stockholder's Equity   |                                |            |
| Retained Earnings Beginning of year   | \$ 11,638                      | \$ 13,265  |
| Retained Earnings End of year   | 34,516                         | 36,412     |

(1) In the prior period, cost of revenue was presented inclusive of intangibles amortization of \$2.9 million.

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## EXHIBIT INDEX

| Exhibit No. | Exhibit   | Incorporated By Reference<br>Filing | Exhibit No. | File No.  | File Date |
|-------------|---|-------------------------------------|-------------|-----------|-----------|
| 3.1         | Natus Medical Incorporated Amended and Restated Certificate of Incorporation  | S-1                                 | 3/1/2001    | 333-44138 | 8/18/2000 |
| 3.2         | Natus Medical Incorporated Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock | 8-A                                 | 3/1/2002    | 000-33001 | 9/6/2002  |
| 3.3         | Bylaws of Natus Medical Incorporated  | 8-K                                 | 3.1         | 000-33001 | 6/18/2008 |
| 10.1        | Form of Indemnification Agreement between Natus Medical Incorporated and each of its directors and officers                           | S-1                                 | 10.1        | 333-44138 | 8/18/2000 |
| 10.2*       | Natus Medical Incorporated Amended and Restated 2000 Stock Awards Plan  | 8-K                                 | 10.1        | 000-33001 | 1/4/2006  |
| 10.2.1*     | Form of Option Agreement under the Amended and Restated 2000 Stock Awards Plan  | S-1                                 | 10/3/2001   | 333-44138 | 8/18/2000 |
| 10.2.2*     | Form of Restricted Stock Purchase Agreement under the Amended and Restated 2000 Stock Awards Plan                                     | 10-Q                                | 10.2        | 000-33001 | 8/9/2006  |
| 10.2.3*     | Form of Restricted Stock Unit Agreement under the Amended and Restated 2000 Stock Awards Plan   | 10-K                                | 10/3/2003   | 000-33001 | 3/14/2008 |
| 10.3*       | Natus Medical Incorporated 2000 Director Option Plan  | 10-Q                                | 10.02       | 000-33001 | 5/9/2008  |
| 10.3.1*     | Form of Option Agreement under the 2000 Director Option Plan  | S-1                                 | 10/4/2001   | 333-44138 | 8/18/2000 |
| 10.4*       | Natus Medical Incorporated 2000 Supplemental Stock Option Plan  | S-1                                 | 10.15       | 333-44138 | 2/9/2001  |
| 10.4.1*     | Form of Option Agreement for 2000 Supplemental Stock Option Plan  | S-1                                 | 10/15/2001  | 333-44138 | 2/9/2001  |
| 10.5*       | Natus Medical Incorporated 2000 Employee Stock Purchase Plan and form of subscription agreement thereunder                            | 8-K                                 | 10.2        | 000-33001 | 1/4/2006  |
| 10.6*       | [Amended] 2011 Stock Awards Plan  | 14-A                                | —           | 000-33001 | 4/20/2011 |
| 10.6.1*     | Form of Stock Option Award Agreement under the [Amended] 2011 Stock Plan  | 10-Q                                | 10.1        | 000-33001 | 11/7/2011 |
| 10.6.2*     | Form of Restricted Stock Award Purchase Agreement   | 10-Q                                | 10.2        | 000-33001 | 11/7/2011 |
| 10.6.3*     | Form of Restricted Stock Unit Agreement   | 10-Q                                | 10.3        | 000-33001 | 11/7/2011 |
| 10.7*       | 2011 Employee Stock Purchase Plan   | 14-A                                | —           | 000-33001 | 4/20/2011 |
| 10.7.1*     | 2011 Employee Stock Purchase Plan Subscription Agreement  | 14-A                                | —           | 000-33001 | 4/20/2011 |
| 10.8*       | Form of Employment Agreement between Natus Medical Incorporated   | 10-K                                | 10.10       | 000-33001 | 3/10/2009 |

and each of its executive officers other  
than its Chief Executive Officer and  
Chief Financial Officer

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| Exhibit No. | Exhibit  | Incorporated By Reference |             | File No.  | File Date |
|-------------|--|---------------------------|-------------|-----------|-----------|
|             |  | Filing                    | Exhibit No. |           |           |
| 10.8.1*     | Form of Amendment to Employment Agreement between Natus Medical Incorporated and each of its executive officers other than its Chief Executive Officer and Chief Financial Officer   |                           |             |           |           |
| 10.9*       | Amended employment agreement between Natus Medical Incorporated and its Chief Executive Officer, James B. Hawkins dated April 19, 2013   | 8-K                       | 99.1        | 000-33001 | 4/22/2013 |
| 10.10*      | Form of Employment Agreement between Natus Medical Incorporated and Jonathan A. Kennedy dated April 8, 2013  | 10-Q                      | 10.1        | 000-33001 | 8/8/2013  |
| 10.11       | Credit Agreement between Natus Medical Incorporated and CitiBank, NA dated October 9, 2015   | 8-K                       | 10.1        | 000-33001 | 10/9/2015 |
| 10.12       | Agreement For the Acquisition of Medical Devices between Medix ICSA and the Ministry of Health of the Republic of Venezuela dated October 15, 2016                                   |                           |             |           |           |
| 16.1        | Letter Regarding Change in Certifying Accountant   | 8-K                       | 16.1        | 000-33001 | 3/28/2014 |
| 21.1        | Significant Subsidiaries of the Registrant   |                           |             |           |           |
| 23.1        | Consent of Independent Registered Public Accounting Firm   |                           |             |           |           |
| 23.2        | Consent of Independent Registered Public Accounting Firm   |                           |             |           |           |
| 24.1        | Power of Attorney (included on signature page)   |                           |             |           |           |
| 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 and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |                           |             |           |           |
| 101.INS     | XBRL Instance Document   |                           |             |           |           |
| 101.SCH     | XBRL Taxonomy Extension Schema Document  |                           |             |           |           |
| 101.CAL     | XBRL Taxonomy Extension Label Calculation Linkbase Document  |                           |             |           |           |
| 101.DEF     | XBRL Taxonomy Extension Definition Document  |                           |             |           |           |

|         |   |
|---------|---|
| 101.LAB | XBRL Taxonomy Extension Label<br>Linkbase Document        |
| 101.PRE | XBRL Taxonomy Extension Presentation<br>Linkbase Document |

\* Indicates a management contract or compensatory plan or arrangement