Xtant Medical Holdings, Inc.
Form 10-Q
May 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2017

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: 001-34951

XTANT MEDICAL HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-5313323**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

664 CRUISER LANE

BELGRADE, MONTANA 59714

(Address of principal executive offices) (Zip code)

(406) 388-0480

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

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

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

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

Number of shares of common stock, $0.000001 par value, of registrant outstanding at May 15, 2017: 18,092,603

XTANT MEDICAL HOLDINGS, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

XTANT MEDICAL HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	As of March 31, 2017 (unaudited)	As of December 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$2,486,839	$2,578,267
Trade accounts receivable, net of allowance for doubtful accounts of $1,889,854 and $1,653,385, respectively	16,320,038	18,991,872
Current inventories, net	26,359,272	26,266,457
Prepaid and other current assets	1,651,187	1,149,615
Total current assets	46,817,336	48,986,211
Non-current inventories, net	440,853	971,854
Property and equipment, net	15,219,725	15,840,730
Goodwill	41,534,626	41,534,626
Intangible assets, net	34,800,556	35,940,810
Other assets	874,561	827,374
Total Assets	$139,687,657	$144,101,605
LIABILITIES and STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable	$8,896,188	$10,471,944
Accounts payable - related party (Note 13)	472,657	640,442
Revolving line of credit	10,293,706	10,448,283
Accrued liabilities	8,815,400	8,982,187
Warrant derivative liability	163,582	333,613
Current portion of capital lease obligations	259,027	244,847
Total current liabilities	28,900,560	31,121,316
Long-term liabilities:		
Capital lease obligation, less current portion	754,994	832,152

Long-term convertible debt, less issuance costs	70,636,665	68,937,247
Long-term debt, less issuance costs	51,069,961	50,284,187
Total Liabilities	151,362,180	151,174,902
Commitments and Contingencies (Note 10)		
Stockholders' Deficit		
Preferred stock, $0.000001 par value; 5,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, $0.000001 par value; 95,000,000 shares authorized; 18,092,603 shares issued and outstanding as of March 31, 2017 and 11,897,601 shares issued and outstanding as of December 31, 2016	18	17
Additional paid-in capital	86,026,911	85,461,210
Accumulated deficit	(97,701,452)	(92,534,524)
Total Stockholders’ Deficit	(11,674,523)	(7,073,297)
Total Liabilities and Stockholders’ Deficit	$139,687,657	$144,101,605

See notes to unaudited condensed consolidated financial statements.

XTANT MEDICAL HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Quarter Ended March 31, 2017	2016
Revenue		
Orthopedic product sales	$21,996,315	$20,808,035
Other revenue	86,354	169,300
Total Revenue	22,082,669	20,977,335
Cost of sales	6,557,602	6,877,267
Gross Profit	15,525,067	14,100,068
Operating Expenses:		
General and administrative	4,128,268	3,484,712
Sales and marketing	10,997,019	10,512,966
Research and development	698,635	899,575
Depreciation and amortization	1,280,965	1,208,334
Acquisition and integration related expenses	-	301,773
Separation related expenses	224,372	-
Non-cash consulting expense	144,723	55,296
Total Operating Expenses	17,473,982	16,462,656
Loss from Operations	(1,948,915)	(2,362,588)
Other Income (Expense):		
Interest expense	(3,400,389)	(2,827,174)
Change in warrant derivative liability	170,031	18,690
Other income (expense)	12,344	(425,000)
Total Other Income (Expense)	(3,218,014)	(3,233,484)
Net Loss from Operations	(5,166,929)	(5,596,072)
Net loss per share:		
Basic	$(0.29)	$(0.47)
Dilutive	$(0.29)	$(0.47)
Shares used in the computation:		
Basic	17,933,315	11,897,601
Dilutive	17,933,315	11,897,601

See notes to unaudited condensed consolidated financial statements.

XTANT MEDICAL HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Quarter Ended March 31,	
	2017	2016
Operating activities:		
Net loss	$(5,166,929)	$(5,596,072)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,071,337	1,779,986
Non-cash interest	3,151,227	2,822,980
Non-cash consulting expense/stock option expense	230,424	136,079
Provision for losses on accounts receivable and inventory	312,588	(72,313)
Change in derivative warrant liability	(170,031)	(18,690)
Changes in operating assets and liabilities:		
Accounts receivable	2,536,242	328,290
Inventories	261,189	(1,144,652)
Prepaid and other assets	(648,769)	(235,779)
Accounts payable	(1,743,541)	3,734,694
Accrued liabilities	(397,532)	(707,214)
Net cash provided by operating activities	436,205	1,027,309
Investing activities:		
Purchases of property and equipment and intangible assets	(310,078)	(2,718,985)
Net cash used in investing activities	(310,078)	(2,718,985)
Financing activities:		
Payments on capital leases	(62,978)	(7,985)
Payments on revolving line of credit	(154,577)	-
Net cash used in financing activities	(217,555)	(7,985)
Net change in cash and cash equivalents	(91,428)	(1,699,661)
Cash and cash equivalents at beginning of period	2,578,267	6,368,016
Cash and cash equivalents at end of period	$2,486,839	$4,668,355

See notes to unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Business Description and Summary of Significant Accounting Policies

Business Description

The accompanying condensed consolidated financial statements include the accounts of Xtant Medical Holdings, Inc. (“Xtant”), formerly known as Bacterin International Holdings, Inc., a Delaware corporation, and its wholly owned subsidiaries, Xtant Medical, Inc., a Delaware corporation, Bacterin International, Inc., (“Bacterin”) a Nevada corporation and X-Spine Systems, Inc. (“X-spine”), an Ohio corporation, (Xtant, Bacterin and X-spine are jointly referred to herein as the “Company”). All intercompany balances and transactions have been eliminated in consolidation. Xtant develops, manufactures and markets regenerative orthopedic products for domestic and international markets and fixation devices. Xtant products serve the combined specialized needs of orthopedic and neurological surgeons, including orthobiologics for the promotion of bone healing, implants and instrumentation for the treatment of spinal disease, tissue grafts for the treatment of orthopedic disorders to promote healing following spine, cranial and foot surgeries and the development, manufacturing and sale of medical devices for use in orthopedic spinal surgeries.

On July 31, 2015, Xtant acquired all of the outstanding capital stock of X-spine for approximately $60 million in cash, repayment of approximately $13 million of X-spine debt, and 4,242,655 shares of Xtant common stock. Following the closing of the acquisition, on July 31, 2015 Bacterin International Holdings, Inc. changed its name to Xtant Medical Holdings, Inc. On August 6, 2015 Xtant formed a new wholly owned subsidiary, Xtant Medical, Inc., a Delaware corporation to facilitate the integration of Bacterin and X-spine.

The markets in which the Company competes are highly competitive and rapidly changing. Significant technological advances, changes in customer requirements, or the emergence of competitive products with new capabilities or technologies could adversely affect the Company’s operating results. The Company’s business could be harmed by a decline in demand for, or in the prices of, its products or as a result of, among other factors, any change in pricing or distribution methods, increased price competition, changes in government regulations or a failure by the Company to keep up with technological change. Further, a decline in available donors could have an adverse impact on our business.

The accompanying interim condensed consolidated financial statements of Xtant for the quarters ended March 31, 2017 and 2016 are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America. They do not include all disclosures required by generally accepted accounting principles for annual financial statements, but in the opinion of management, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation. Interim results are not necessarily indicative of results which may be achieved in the future for the full year ending December 31, 2017.

These condensed financial statements should be read in conjunction with the financial statements and notes thereto which are included in Xtant's Annual Report on Form 10-K for the year ended December 31, 2016. The accounting policies set forth in those annual financial statements are the same as the accounting policies utilized in the preparation of these financial statements, except as modified for appropriate interim financial statement presentation.

Going Concern

The Company has incurred losses since its inception. The terms, conditions and amounts outstanding under the Company's debt agreements (See Note 7, "Debt" below) raise substantial doubt about the Company's ability to continue as a going concern. The Company has established a special committee of its board of directors to evaluate restructuring alternatives, assist in related negotiations with the Company's lenders and consider alternatives for raising new capital. The Company also is evaluating various cost-reduction and cash flow improvement measures. However, there can be no assurance that the Company will be successful in these efforts.

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern; however, the above conditions raise substantial doubt about the Company's ability to do so. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the Company be unable to continue as a going concern.

Concentrations and Credit Risk

The Company's accounts receivable are due from a variety of health care organizations and distributors throughout the world. No single customer accounted for more than 10% of revenue or accounts receivable for the comparable periods. The Company provides for uncollectible amounts when specific credit issues arise. Management's estimates for uncollectible amounts have been adequate during prior periods, and management believes that all significant credit risks have been identified at March 31, 2017.

In the quarter ended March 31, 2017, Xtant purchased from Norwood Medical less than 10% of its operating products (See Note 13, "Related Party Transactions" below) and approximately 18% for the same period in 2016.

Use of Estimates

The preparation of the financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Significant estimates include the carrying amount of property and equipment, goodwill, and intangible assets and liabilities; valuation allowances for trade receivables, inventory, and deferred income tax assets and liabilities;

valuation of the warrant derivative liability, inventory, and estimates for the fair value of stock options grants and other equity awards upon which the Company determines stock-based compensation expense. Actual results could differ from those estimates.

Long-Lived Assets

Long-lived assets, including intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets

Goodwill

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have indefinite useful lives are not amortized, instead they are tested for impairment at least annually and whenever events or circumstances indicate the carrying amount of such asset may not be recoverable. In its evaluation of goodwill, the Company performs an assessment of qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment. The Company conducts its annual impairment test on December 31 of each year.

Revenue Recognition

Revenue is recognized when all of the following criteria are met: a) the Company has entered into a legally binding agreement with the customer; b) the products or services have been delivered; c) the Company's fee for providing the products and services is fixed or determinable; and d) collection of the Company's fee is probable.

The Company's policy is to record revenue net of any applicable sales, use, or excise taxes. If an arrangement includes a right of acceptance or a right to cancel, revenue is recognized when acceptance is received or the right to cancel has expired.

The Company ships to certain customers under consignment arrangements whereby the Company's product is stored by the customer. The customer is required to report the use to the Company and upon such notice, the Company invoices the customer and revenue is recognized when above criteria have been met.

Research and Development

Research and development costs, which are principally related to internal costs for the development of new devices and biologics and processes are expensed as incurred.

Other Income (Expense)

Other income (expense) primarily consists of non-recurring items that are outside of the normal Company's operations such as other related legal expenses, gain or loss on the sale of fixed assets and miscellaneous minor adjustments to account balances.

Net Loss Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding. Shares issued during the period and shares reacquired during the period are weighted for the portion of the period that they were outstanding. Diluted net income (loss) per share is computed in a manner consistent with that of basic earnings per share while giving effect to all potentially dilutive common shares outstanding during the period, which include the assumed exercise of stock options and warrants using the treasury stock method. Diluted net loss per share was the same as basic net loss per share for the quarters ended March 31, 2017 and 2016, as shares issuable upon the exercise of stock options and warrants were anti-dilutive as a result of the net losses incurred for those periods. Dilutive earnings per share are not reported as their effects of including 7,479,410 and 1,861,272 outstanding stock options and warrants for the quarters ended March 31, 2017 and 2016, respectively, are anti-dilutive.

Fair Value of Financial Instruments

The carrying values of financial instruments, including trade accounts receivable, accounts payable, other accrued expenses and long-term debt, approximate their fair values based on terms and related interest rates.

The Company follows a framework for measuring fair value. The framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. During the quarters ended March 31, 2017 and 2016, there was no reclassification in financial assets or liabilities between Level 1, 2 or 3 categories.

The following table sets forth by level, within the fair value hierarchy, our liabilities that are measured at fair value on a recurring basis:

Warrant derivative liability

	As of March 31, 2017	As of December 31, 2016
Level 1	-	-
Level 2	-	-
Level 3	$ 163,582	$ 333,613

The valuation technique used to measure fair value of the warrant liability is based on a lattice valuation model and significant assumptions and inputs determined by us (See Note 9, "Warrants" below).

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Level 3 Changes

The following is a reconciliation of the beginning and ending balances for liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the quarter ended March 31, 2017:

Warrant derivative liability

Balance at January 1, 2016	$1,050,351
Gain recognized in earnings	(716,738)
Balance at January 1, 2017	$333,613
Gain recognized in earnings	(170,031)
Balance at March 31, 2017	$163,582

During the quarter ended March 31, 2017, the Company did not change any of the valuation techniques used to measure its liabilities at fair value.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers. The new standard was originally effective for reporting periods beginning after December 15, 2016 and early adoption was not permitted. On August 12, 2015, the FASB approved a one year delay of the effective date to reporting periods beginning after December 15, 2017, while permitting companies to voluntarily adopt the new standard as of the original effective date. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. Adoption of the new rules could affect the timing of revenue recognition for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The Company is currently evaluating the impacts of adoption and the implementation approach to be used.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)*. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. While we are still evaluating the impact of our pending adoption of the new standard on our financial statements, we expect that upon adoption we will recognize ROU assets and lease liabilities and that the amounts could be material.

(2) Equity

We entered into a purchase agreement on March 16, 2015, as amended and restated on April 17, 2015, with Aspire Capital, which provides that, upon the terms and subject to the conditions and limitations set forth therein, Aspire Capital was committed to purchase up to an aggregate of $10 million of our shares of common stock until the agreement expired in the quarter ending March 31, 2017. Pursuant to the terms of the purchase agreement, in the first quarter of 2017 and 2016 we issued zero shares of our common stock to Aspire Capital.

In connection with the offering of units pursuant to the subscription rights, referred to as the "Rights Offering.", the Company distributed to holders of its common stock and to holders of its convertible notes, at no charge, non-transferable subscription rights to purchase units. Each unit consisted of one share of common stock and one tradeable warrant representing the right to purchase one share of common stock ("Tradeable Warrants"). On October 31, 2016, the Company entered into a dealer-manager agreement (the "Dealer-Manager Agreement") with Maxim Group LLC ("Maxim"), to engage Maxim as dealer-manager for the Rights Offering.

In the Rights Offering, holders received two subscription rights for each share of common stock, or each share of common stock underlying our convertible notes owned on the record date, October 21, 2016. Subscribers whose subscriptions otherwise would have resulted in their beneficial ownership of more than 4.99% of the Company's common stock could elect to receive, in lieu of shares of common stock in excess of that threshold, pre-funded warrants to purchase the same number of shares of common stock for $0.01 ("Pre-Funded Warrants"), and the subscription price per unit consisting of a Pre-Funded Warrant in lieu of a share of common stock was reduced by the $0.01 exercise price. No Pre-Funded Warrants were sold in the Rights Offering.

The Rights Offering closed on November 14, 2016. The units were priced at $0.75 per unit with gross proceeds from the Rights Offering of approximately $3.8 million and the net proceeds from the Rights Offering of approximately $2.5 million after deducting fees and expenses payable, and after deducting other expenses payable by us and excluding any proceeds received upon exercise of any Tradeable Warrants issued in the offering. Each Tradeable Warrant is exercisable for a period of five years for one share of common stock at an exercise price of $0.90 per share. The Tradeable Warrants associated with the equity raised were subject to an analysis that resulted in the Tradeable Warrants being recorded as equity with the common stock in stockholder's equity. After the one-year anniversary of issuance, we may redeem the Tradeable Warrants for $0.01 per Tradeable Warrant if the volume weighted average price of our common stock is above $2.25 for each of 10 consecutive trading days.

In connection with the Rights Offering, the Company paid to Maxim a cash fee equal to 7% of the gross proceeds received by us directly from exercises of Subscription Rights. We also reimbursed Maxim $75,000 for expenses incurred in connection with the Rights Offering.

Under the terms and subject to the conditions contained in the Dealer-Manager Agreement, the Company agreed not to issue or announce the issuance of any shares of common stock or common stock equivalents until 90 days after the closing date of the Rights Offering, without the consent of Maxim, subject to certain exceptions including a pre-existing agreement, equity awards, conversion of derivative securities and in connection with any acquisitions, partnerships or strategic transactions.

(3) Inventories, Net

Inventories consist of the following:

	March 31, 2017	December 31, 2016
Current inventories:		
Raw materials	$4,192,054	$4,833,403
Work in process	1,523,002	1,891,380
Finished goods	25,002,633	23,878,040
Gross current inventories	30,717,689	