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

FORM 10-Q

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

For the quarterly period ended September 30, 2016
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

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

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

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

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

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

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

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

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

The number of shares of the registrant’s Common Stock, $0.01 par value, outstanding as of November 2, 2016 was 11,205,282.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Total revenue, net	$31,741	$32,679	$96,341	$98,454
Cost of goods sold	13,881	17,341	42,094	44,448
Gross profit	17,860	15,338	54,247	54,006
Operating expenses:				
Selling, general and administrative	23,803	26,348	76,166	83,059
Research and development	2,600	2,364	8,534	5,973
Intangible amortization	955	1,295	3,517	4,049
Total operating expenses	27,358	30,007	88,217	93,081
Operating loss	(9,498)	(14,669)	(33,970)	(39,075)
Other income (expense), net	(59)	195	(33)	(577)
Loss before income taxes	(9,557)	(14,474)	(34,003)	(39,652)
Provision (benefit) for income taxes	(103)	(275)	(559)	2,130
Net loss	$(9,454)	$(14,199)	$(33,444)	$(41,782)
Net loss per share, basic and diluted	$(0.84)	$(1.27)	$(2.98)	$(3.75)
Weighted average shares used to compute basic and diluted net loss per share	11,271	11,171	11,206	11,130

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	$(9,454)	$(14,199)	$(33,444)	$(41,782)
Other comprehensive income				
Foreign currency translation adjustments	45	525	131	937
Comprehensive loss	$(9,409)	$(13,674)	$(33,313)	$(40,845)

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

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

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,808	$ 33,429
Trade accounts receivable, net of allowances of $594 and $764	21,202	25,326
Inventories	48,176	51,271
Prepaid expenses and other current assets	2,648	3,696
Total current assets	92,834	113,722
Property, plant and equipment, net	22,362	21,958
Intangible assets, net	43,526	39,632
Other assets	974	1,077
Total assets	$ 159,696	$ 176,389
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 824	$ —
Accounts payable, trade	10,926	13,689
Accrued compensation	4,294	4,177
Accrued commissions	3,953	4,227
Contingent consideration liabilities- current	3,250	—
Accrued expenses and other current liabilities	5,097	3,942
Total current liabilities	28,344	26,035
Long-term borrowings under credit facility	3,750	328
Contingent consideration liabilities- non-current	5,050	—
Other liabilities	2,921	2,687
Total liabilities	40,065	29,050
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 15,000 authorized; none issued and outstanding	—	—
Common stock, $0.01 par value; 60,000 authorized; 11,205 shares issued and outstanding at September 30, 2016, and 11,102 shares issued and outstanding at December 31, 2015	112	111
Additional paid-in capital	179,390	173,786
Accumulated other comprehensive income	1,522	1,391
Accumulated deficit	(61,393)	(27,949)
Total stockholders' equity	119,631	147,339
Total liabilities and stockholders' equity	$ 159,696	$ 176,389

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

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

	Nine Months Ended September 30, 2016	2015
OPERATING ACTIVITIES:		
Net loss	$(33,444)	$(41,782)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	8,984	9,169
Spinal hardware instrument replacement expense	950	944
Impairment of spinal hardware instruments	919	175
Provision for excess and obsolete inventories	4,057	6,069
Amortization of debt issuance costs	105	—
Deferred income tax benefit	(80)	—
Stock-based compensation	5,406	1,775
Allocation of non-cash charges from Integra	—	563
Changes in assets and liabilities		
Accounts receivable	4,182	(2,099)
Inventories	87	(8,752)
Prepaid expenses and other current assets	1,051	5,612
Other non-current assets	102	(6,164)
Income taxes payable	—	406
Accrued commissions	(277)	—
Accounts payable, accrued expenses and other current liabilities	(2,652)	6,626
Other non-current liabilities	204	(1,993)
Net cash used in operating activities	(10,406)	(29,451)
INVESTING ACTIVITIES:		
Purchases of property and equipment	(5,707)	(9,826)
Additions to technology assets	(1,150)	(150)
Net cash used in investing activities	(6,857)	(9,976)
FINANCING ACTIVITIES:		
Borrowings under credit facility	3,300	—
Borrowings under short-term debt	1,202	—
Repayments of short-term debt	(378)	—
Proceeds from the issuance of common stock	356	—
Other financing activity	(25)	—
Integra net investment prior to the spin-off	—	77,173
Excess tax benefits from stock-based compensation arrangements	—	37
Net cash provided by financing activities	4,455	77,210
Effect of exchange rate changes on cash and cash equivalents	187	68
Net change in cash and cash equivalents	(12,621)	37,851
Cash and cash equivalents at beginning of period	33,429	652
Cash and cash equivalents at end of period	$20,808	$38,503
Non-cash financing activities:		
Settlement of related-party payable to Integra net investment	$—	$29,022
Non-cash investing activities:		

Property and equipment in liabilities	$1,556	$1,419
Fair value of intangible assets acquired through acquisition of business (see Note 8)	$8,300	$—
Fair value of contingent consideration liabilities in connection with acquisition of business (see Note 8)	$8,300	$—

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

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

	Common Stock		Additional	Accumulated Other		Total
	Number of Shares	Amount	Paid-In Capital	Comprehensive Income	Accumulated Deficit	Stockholder's Equity
Balance December 31, 2015	11,102	$ 111	$ 173,786	$ 1,391	$ (27,949)	$ 147,339
Net loss	—	—	—	—	(33,444)	(33,444)
Foreign currency translation adjustment	—	—	—	131	—	131
Restricted stock awards issued	75	1	(1)	—	—	—
Issuance of common stock under employee stock purchase plan	40	—	356	—	—	356
Restricted stock awards forfeited	(12)	—	(157)	—	—	(157)
Stock-based compensation	—	—	5,406	—	—	5,406
Balance September 30, 2016	11,205	$ 112	$ 179,390	$ 1,522	$ (61,393)	$ 119,631

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

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SEASPINE HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS
Spin-off from Integra

SeaSpine Holdings Corporation ("SeaSpine" or the "Company") was incorporated in Delaware on February 12, 2015. As of June 30, 2015, SeaSpine was a subsidiary of Integra LifeSciences Holdings Corporation ("Integra"). On July 1, 2015, Integra completed the spin-off of its orthobiologics and spinal fusion hardware business into SeaSpine, which was created to be a separate, independent, publicly-traded medical technology company focused on the design, development and commercialization of surgical solutions for the treatment of patients suffering from spinal disorders. Unless the context indicates otherwise, (i) references to "SeaSpine", the "Company", and the "Business", refer to SeaSpine Holdings Corporation and the Company's orthobiologics and spinal fusion hardware business and (ii) references to "Integra" refer to Integra LifeSciences Holdings Corporation and its subsidiaries other than SeaSpine.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The Company prepared the unaudited interim condensed consolidated financial statements included in this report in accordance with accounting principles generally accepted in the U.S. (“GAAP”) for interim financial information and the rules and regulations of the SEC related to quarterly reports on Form 10-Q.

For periods prior to the spin-off, the Company’s consolidated financial statements were prepared on a stand-alone basis and derived from Integra's consolidated financial statements and accounting records related to its orthobiologics and spinal fusion hardware business. The Company relied on Integra for a significant portion of its operational and administrative support. The consolidated financial statements for all periods prior to the spin-off included allocations of certain Integra corporate expenses, including information technology resources and support; finance, accounting, and auditing services; real estate and facility management services; human resources activities; certain procurement activities; treasury services, legal advisory services and costs for research and development. These costs were allocated to the Company on the basis of direct usage when identifiable, with the remainder allocated on a pro-rata basis of revenue, standard costs of sales, or other measures.
Integra used a centralized approach to cash management and financing of its operations and substantially all cash generated by the Company through May 4, 2015, the date the Company implemented its own separate enterprise resource planning system, was assumed to be remitted to Integra. Prior to the spin-off, cash management and financing transactions relating to the Company were accounted for through the Integra invested equity account. Accordingly, none of the Integra cash and cash equivalents at the corporate level was assigned to SeaSpine in the consolidated financial statements. Integra’s debt and related interest expense were not allocated to SeaSpine for any of the periods presented since SeaSpine was not the legal obligor of the debt and Integra’s borrowings were not directly attributable to SeaSpine.
Subsequent to the spin-off, the Company’s financial statements are presented on a consolidated basis, as the Company became a separate publicly-traded company on July 1, 2015. The unaudited interim condensed consolidated financial statements do not include all information and disclosures required by GAAP for annual audited financial statements and should be read in conjunction with the Company’s consolidated financial statements and notes thereto for the year ended December 31, 2015 included in the Company’s Annual Report on Form 10-K filed with the Securities and

Exchange Commission ("SEC"). In the opinion of management, the September 30, 2016 unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations, cash flows, and statement of equity for periods presented. The results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results expected for the full year. The condensed consolidated balance sheet as of December 31, 2015 was derived from the audited consolidated financial statements for the year ended December 31, 2015.

See Note 4, “Transactions with Integra,” for further information regarding the relationships the Company has with Integra.

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

Principles of Consolidation

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

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

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should: 1) identify the contract(s) with a customer, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. In July 2015, the FASB deferred for one year the effective date of the new revenue standard, but early adoption
is permitted. In April and May 2016, the FASB issued ASU No. 2016-10 and ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606), which do not change the core principle of the guidance in Topic 606 stated in Update No. 2014-09. Rather, they clarify identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas, and address certain issues identified by the Transition Resource Group for Revenue Recognition in the guidance on assessing collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. The new standard will be effective for the Company on January 1, 2018. The Company is in the process of evaluating the impact of this standard on its financial statements.

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

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

In February 2016, the FASB issued Update No. 2016-02, Leases (Topic 842), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e. lessees and lessors).

The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. Topic 842 supersedes the previous leases standard, Topic 840 Leases. The standard is effective on January 1, 2019, with early adoption permitted. The Company is in the process of evaluating the impact of this new guidance.

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

The Company elected to early adopt ASU 2016-09 as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. Amendments related to accounting for excess tax benefits (deficiencies) have been adopted prospectively, and recognition of excess tax benefits (deficiencies) against income tax expenses is immaterial for the three and nine months ended September 30, 2016. The Company elected to apply the change in classification for excess tax benefits in the statement of cash flows on a prospective basis, and elected to continue estimating stock-based compensation award forfeitures in determining the amount of compensation cost to be recognized each period.

In May 2016, the FASB issued Update No. 2016-11, Revenue Recognition (Topic 605) and Derivative and Hedging (Topic 815). This Update rescinds certain SEC Staff Observer Comments that are codified in Topic 605, Revenue Recognition, and Topic 932, Extract Activities - Oil and Gas, upon adoption of Topic 606, Revenue from Contracts with Customers. Specifically, registrants should not rely on the following SEC Staff Observer comments: a. Revenue and Expense Recognition for Freight Services in Process; b. Accounting for Shipping and Handling Fees and Costs; c. Accounting for Consideration Given by a Vendor to a Customer (including Reseller of the Vendor's Products); d. Accounting for Gas-Balancing Arrangements (that is, use of the "entitlements method"). The new standard will be effective for the Company upon adoption of Topic 606 on January 1, 2018. The implementation of the amended guidance is not expected to have an impact on our financial statements.

In August 2016, the FASB issued Update No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This Update address eight specific cash flow issues related to cash receipts and cash payments with the objective of reducing the existing diversity of presentation and classification in the statement of cash flows. The new standard will be effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted and should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company is in the process of evaluating the impact of this standard on its financial statements.

Net Loss Per Share

Basic and diluted net loss per share was calculated using the weighted-average number of shares of common stock outstanding during the period. The weighted average number of shares used to compute diluted net loss per share excludes any assumed exercise of stock options, and any assumed issuance of common stock under restricted stock units and the Employee Stock Purchase Plan as the effect would be antidilutive. Common stock equivalents of 2.9 million and 1.8 million shares for the three and nine months ended September 30, 2016 and 2015, respectively, were excluded from the calculation because of their antidilutive effect.

Out-of-Period Adjustment

In the third quarter of 2016, the Company recorded an adjustment to correct an error in the first quarter of 2016 reported
amounts. This resulted in an increase to cost of goods sold by $0.6 million for the three months ended September 30, 2016. The error had the effect of overstating the inventory balance and understating the cost of goods sold, in each case, by $0.6 million for the three months ended March 31, 2016. The adjustment recorded in the third quarter of 2016 corrects the balance sheet and cost of goods sold for the nine months ended September 30, 2016. The impact to the

periods presented and the previously issued financial statements is not material.

3. DEBT AND INTEREST

Credit Agreement

On December 24, 2015, the Company entered into a three-year credit facility (the "Credit Facility") with Wells Fargo Capital Finance. The Credit Facility provides an asset-backed revolving line of credit of up to $30.0 million in borrowing capacity with a maturity date of December 24, 2018, which maturity date is subject to a one-year extension at the Company's election. In connection with the Credit Facility, the Company was required to become guarantors and to provide a security interest in substantially all its assets for the benefit of the counterparty.

Borrowings under the Credit Facility accrue interest at the rate then applicable to the Base Rate (as customarily defined) Loans, unless and until converted into LIBOR Rate Loans in accordance with the terms of the Credit Facility. Borrowings bear interest at a floating annual rate equal to (a) during any month for which the Company's average excess availability (as customarily defined) is greater than $20.0 million, base rate plus (i) 1.25 percentage points for base rate loans and (ii) LIBOR rate plus 2.25 percentage

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

points for LIBOR loans, (b) during any month for which the Company's average excess availability is greater than $10.0 million but less than or equal to $20.0 million, (i) base rate plus 1.50 percentage points for base rate loans and (ii) LIBOR rate plus 2.50 percentage points for LIBOR loans and (c) during any month for which the Company's average excess availability is less than or equal to $10.0 million, (i) base rate plus 1.75 percentage points for base rate loans and (ii) LIBOR rate plus 2.75 percentage points for LIBOR loans. The Company will also pay an unused line fee in an amount equal to 0.375% per annum of the unused Credit Facility amount. The unused line fee is due and payable on the first day of each month.

In September 2016, the Company borrowed $3.3 million from the revolving line of credit. The Company elected to use the LIBOR Rate with an interest period of six months commencing on September 28, 2016. At September 30, 2016, there was $3.8 million outstanding in total debt under the Credit Facility. Debt issuance costs and legal fees related to the Credit Facility totaling $0.4 million were recorded as a deferred asset and are being amortized ratably over the term of the arrangement.

The Credit Facility contains various customary affirmative and negative covenants, including prohibiting the Company from incurring indebtedness without the lender’s consent. The Credit Facility also includes a financial covenant that requires the Company to maintain a minimum fixed charge coverage ratio of 1.10 to 1.00 for the applicable measurement period, if the Company's Total Liquidity (as defined in the Credit Facility) is less than $5.0 million. The Company was in compliance with all applicable covenants at September 30, 2016.

The Credit Facility also includes customary events of default, including events relating to non-payment of amounts due under the Credit Facility, material inaccuracy of representations and warranties, violation of covenants, bankruptcy and insolvency, failure to comply with health care laws, violation of certain of the Company’s existing agreements, and the occurrence of a change of control. Under the Credit Facility, if an event of default occurs, Wells Fargo Capital Finance will have the right to terminate the commitments and accelerate the maturity of any loans outstanding.

Insurance Premium Finance Agreements

In July 2016, the Company entered into two insurance premium finance agreements (the "Finance Agreements") with First Insurance Funding Corporation and AFCO Acceptance Corporation (the "Lenders"), under which the Lenders will pay premiums, taxes and fees to insurance companies on the Company's behalf for various insurance policies under which the Company is the insured for a policy term of 12 months. Under the Finance Agreements, the Company will pay to the Lenders the financed amount of $1.2 million including immaterial amounts of finance charges with annual interest rates between 2% and 4% within the next 12 months. The Company recorded the total amounts due to the Lenders as a short-term debt on the balance sheet. At September 30, 2016, there was $0.8 million outstanding under the Finance Agreements.

4. TRANSACTIONS WITH INTEGRA

Related-party Transactions

Prior to the spin-off, and pursuant to certain supply agreements subsequent to the spin-off, SeaSpine purchased a portion of raw materials and finished goods from Integra for SeaSpine's Mozaik family of products, and SeaSpine contract manufactured certain finished goods for Integra. The Company's purchases of raw materials and Mozaik product finished goods from Integra for the three months ended September 30, 2016 and 2015 totaled $0.1 million and $1.9 million, respectively, and for the nine months ended September 30, 2016 and 2015 totaled $1.1 million and $5.6 million, respectively. The Company's sale of finished goods sold to Integra under its contract manufacturing arrangement for the three months ended September 30, 2016 and for the three and nine months ended September 30, 2015 was immaterial, and for the nine months ended September 30, 2016 totaled $0.2 million.

Pursuant to a transition services agreement, Integra and SeaSpine have provided, and will continue to provide, certain services to one another following the spin-off, and Integra and SeaSpine will indemnify each other against certain liabilities arising from their respective businesses. Under this agreement, Integra provides the Company with certain support functions, including information technology, accounting and other financial functions, regulatory affairs and quality assurance, human resources and other administrative support. The Company incurred approximately $0.3 million of expenses under the agreement for the nine months ended September 30, 2016, nearly all of which was paid at September 30, 2016. Such expenses for the three months ended September 30, 2016 were immaterial. Expenses incurred by the Company under the agreement for both the three and nine months ended September 30, 2015 totaled $1.8 million.

Allocated Costs

For periods prior to the spin-off, the condensed consolidated statements of operations included direct expenses for cost of goods sold, research and development, sales and marketing, customer service, and administration as well as allocations of expenses arising from shared services and infrastructure provided by Integra to the Company, such as costs of information

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

technology, including the costs of a multi-year global enterprise resource planning implementation, accounting and legal services, real estate and facilities management, corporate advertising, insurance and treasury services, and other corporate and infrastructure services. These allocations are included in the table below. These expenses were allocated to the Company using estimates that the Company considers to be a reasonable reflection of the utilization of services provided to or benefits received from the Company. The allocation methods include pro-rata basis of revenue, standard cost of sales or other measures.

	Nine Months Ended September 30, 2015 (In thousands)
Cost of goods sold	$ 488
Selling, general and administrative	8,633
Research and development	253
Total Allocated Costs	$ 9,374

Included in the above amounts are certain non-cash allocated costs, including stock-based compensation of $0.6 million. There were no allocated costs for the three months ended September 30, 2015 or for the three and nine months ended September 30, 2016.

All significant related party transactions between SeaSpine and Integra were included in the condensed consolidated financial statements and, prior to the spin-off, were considered to be effectively settled for cash at the time the transaction was recorded, with the exception of the purchases by SeaSpine from Integra of Mozaik raw materials and finished goods for all periods presented. The total net effect of the transactions considered to be effectively settled for cash was reflected in the consolidated statement of cash flows as a financing activity.

The following table summarizes the components of the net increase in Integra net investment for the nine months ended September 30, 2015. The Integra net investment was reclassified to Additional Paid-in Capital in connection with the spin-off.

	Nine Months Ended September 30, 2015 (In thousands)
Cash pooling and general financing activities (a)	$ 68,386
Corporate Allocations (excluding non-cash adjustments)	8,787
Total Integra net investment in financing activities within cash flow statement	77,173
Non-cash adjustments (b)	29,806
Separation related adjustments (c)	(166)
Reclassification of Integra net investment in connection with the spin-off	(169,914)
Foreign exchange impact	293
Net increase in Integra investment	$ (62,808)

(a) Includes financing activities for capital transfers, cash sweeps and other treasury services.

(b) Reflects allocation of non-cash charges from Integra, including stock-based compensation and settlement of related-party payable to Integra net investment.

(c) During the three months ended September 30, 2015, certain spin-off related adjustments were recorded in stockholders' equity, to reflect the appropriate opening balances related to SeaSpine’s legal entities at the

Distribution Date.

5. INVENTORIES

Inventories consisted of the following:

	September 30, 2016	December 31, 2015
	(In thousands)	
Finished goods	$33,067	$ 29,845
Work in process	11,488	15,574
Raw materials	3,621	5,852
	$48,176	$ 51,271

6. PROPERTY, PLANT AND EQUIPMENT

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Property, plant and equipment are stated at historical cost less accumulated depreciation and any impairment charges. The Company provides for depreciation using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the lease term or the useful life. The cost of major additions and improvements is capitalized, while maintenance and repair costs that do not improve or extend the lives of the respective assets are charged to operations as incurred. The cost of computer software obtained for internal use is accounted for in accordance with the Accounting Standards Codification 350-40, Internal-Use Software.
The cost of purchased spinal hardware instruments which the Company consigns to hospitals and independent sales agents to support surgeries is initially capitalized as construction in progress. The amount is then reclassified to spinal hardware instrument sets and depreciation is initiated when instruments are put together in a newly built set with spinal implants, or directly expensed for the instruments that are used to replace damaged instruments in an existing set. The depreciation expense and direct expense for replacement instruments are recorded in selling, general and administrative expense.
Property, plant and equipment balances and corresponding useful lives were as follows:

	September 30, 2016	December 31, 2015	Useful Lives
	(In thousands)		
Leasehold improvement	$6,371	$ 4,830	Lease Term
Machinery and production equipment	6,695	6,404	3-10 years
Spinal hardware instrument sets	26,022	25,080	5 years
Information systems and hardware	7,552	6,872	3-7 years
Furniture and fixtures	1,246	944	3-5 years
Construction in progress	8,213	8,375	
Total	56,099	52,505	
Less accumulated depreciation and amortization	(33,737)	(30,547)	
Property, plant and equipment, net	$22,362	$ 21,958	

Depreciation and amortization expenses totaled $1.1 million and $1.3 million for the three months ended September 30, 2016 and 2015, respectively, and $3.4 million and $3.1 million for the nine months ended September 30, 2016 and 2015, respectively. The cost of purchased instruments used to replace damaged instruments in existing sets and recorded directly to the instrument replacement expense totaled $0.2 million and $0.4 million for the three months ended September 30, 2016 and 2015, respectively, and $1.0 million and $0.9 million for the nine months ended September 30, 2016 and 2015, respectively.

7. IDENTIFIABLE INTANGIBLE ASSETS

Identifiable intangible assets are initially recorded at fair value at the time of acquisition generally using an income or cost approach. The Company capitalizes costs incurred to renew or extend the term of recognized intangible assets and amortizes those costs over their expected useful lives.
The components of the Company's identifiable intangible assets were as follows:

	September 30, 2016			
	Weighted Average Life	Cost	Accumulated Amortization	Net
	(Dollars in thousands)			
Product technology	12 years	$40,619	$ (21,320)	$19,299
Customer relationships	12 years	56,830	(32,603)	24,227
Trademarks/brand names	—	300	(300)	—
		$97,749	$ (54,223)	$43,526

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	December 31, 2015			
	Weighted Average Life	Cost	Accumulated Amortization	Net
	(Dollars in thousands)			
Product technology	12 years	$31,169	$ (19,280)	$11,889
Customer relationships	12 years	56,830	(29,087)	27,743
Trademarks/brand names	—	300	(300)	—
		$88,299	$ (48,667)	$39,632

Annual amortization expense (including amounts reported in cost of goods sold) is expected to be approximately $7.3 million in 2016, $6.8 million in 2017, $6.5 million in 2018, $5.8 million in 2019 and $4.9 million in 2020. Amortization expense totaled $1.6 million and $2.0 million for the three months ended September 30, 2016 and 2015, respectively, and includes $0.7 million of amortization of product technology-based intangible assets. Amortization expense totaled $5.6 million and $6.1 million for the nine months ended September 30, 2016 and 2015, respectively, and includes $2.0 million of amortization of product technology-based intangible assets. The amortization of product technology-based intangible assets is presented by the Company within cost of goods sold.

8. BUSINESS COMBINATIONS

In August 2016, the Company entered into an Asset Purchase Agreement (“APA”) with N.L.T Spine Ltd. (“NLT”), and NLT Spine, Inc., a wholly owned subsidiary of NLT, pursuant to which the Company agreed to purchase certain of the assets (the “Purchased Assets”) of NLT’s medical device business (the “Medical Device Business”), including substantially all of NLT’s medical device intellectual property (the “Medical Device Intellectual Property”). NLT owns certain assets related to the ownership, design, development, manufacture, marketing and commercial exploitation of certain expandable interbody medical devices. The acquisition was undertaken to expand the Company's growth in interbody medical devices, one of the fastest growing market segments of the spine hardware market.

Upon the terms and subject to the conditions of the APA, at the initial closing (as defined in the APA), the Company entered into (i) an exclusive license agreement with NLT, pursuant to which the Company will receive an exclusive, worldwide license to make, use, import, offer for sale, sell and otherwise commercially exploit NLT’s medical device products (the “Medical Device Products”), (ii) a transition services agreement with NLT, pursuant to which NLT will provide certain services in respect of the continued development of the Medical Device Intellectual Property and Medical Device Products and (iii) a non-competition and non-solicitation agreement with NLT, pursuant to which NLT and its affiliates agree not to compete with the Company with respect to the Medical Device Business, subject to certain exceptions.

The purchase price consisted of an initial cash payment to NLT of $1.0 million, which was paid on September 26, 2016 upon the initial closing, and $3.5 million worth of shares (the "Shares") of the Company’s common stock (the "Stock Consideration"), which is anticipated to be issued during the fourth quarter of 2016. The number of shares is determined based on the volume weighted average closing price (“VWAP”) of the common stock during the twenty trading day period ending one trading day prior to the issuance date of the Stock Consideration, provided, however, that the minimum VWAP shall be $10.00 and the maximum VWAP shall be $17.00. If any sale of Shares results in aggregate net proceeds to NLT in excess of $3.5 million, then NLT shall pay to the Company, in cash, an amount equal to one-half of the net proceeds received by NLT from such sale and each subsequent sale of Shares.

There are also maximum milestone payments of $5.0 million, payable in cash or the Company's common stock, at the Company's election, which are contingent on the Company's achievement of four independent events related to the commercialization of the Medical Device Products. In connection with the acquisition, after the initial closing the Company will pay NLT contingent asset purchase payments equal to declining (over time) percentages of the Company’s future net sales of certain of the Medical Device Products not to exceed $43.0 million in the aggregate. In addition, the Company has the option to terminate any future obligation to make royalty payments by making a one-time cash payment to NLT of $18.0 million.

The Company accounted for this transaction as a business combination in accordance with Accounting Standards Codification ("ASC") 805 Business Combinations, and as such, the assets acquired have been recorded at their respective fair values. There were no liabilities assumed. The determination of fair value for the identifiable intangible assets acquired requires extensive use of estimates and judgments. Significant estimates include, but are not limited to, measurements estimating cash flows and determining the appropriate discount rate, which are considered Level 3 inputs, as defined using the fair value concepts defined in ASC 820. Intangible assets acquired were fair valued at $9.3 million as of the initial closing date and recorded as Product Technology intangible assets, which are being amortized ratably over a useful life of 10 years from the initial closing. Acquisition costs of $0.5 million incurred were recorded as selling, marketing and administrative.

The following table summarizes the preliminary estimated fair value of total consideration to be paid to NLT. The Company estimated the fair value of the contingent consideration, including milestone obligations and royalty obligations, using a probability weighted approach that considers the possible outcomes based on assumptions related to the timing and probability of the product launch dates, discount rates matched to the timing of payments, and probability of success rates and discount adjustments on the related cash flows. Subsequent to the acquisition date, at each reporting period, the contingent consideration liabilities will be remeasured at current fair value with changes to be recorded in the consolidated statements of operations. The total purchase price is allocated to the intangible assets subject to amortization based on their fair values, which are the sole assets acquired in connection with this acquisition.

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(In thousands)	
Cash paid for purchase	$1,000
Contingent closing consideration	3,100
Contingent milestone payments	2,300
Contingent asset purchase payments	2,900
Total purchase price	$9,300

The Company is still in the process of finalizing the valuation of contingent consideration liabilities and intangible assets. Certain assumptions that were in place at the initial closing could result in material changes in the purchase price allocation. The Company anticipates finalizing the purchase price allocation in the fourth quarter of 2016.

The results of operations of the NLT Purchased Assets are not included in our consolidated statements of operations for the three and nine months ended September 30, 2016 as the initial close of the transaction occurred on September 26, 2016. The balance sheet as of September 30, 2016 includes the estimated fair value of assets acquired from NLT. The unaudited pro forma financial information set forth below assumes that the NLT Purchased Assets had been acquired on January 1, 2015. The unaudited pro forma financial information includes the effect of estimated amortization charges for acquired intangible assets of $0.2 million and $0.6 million for the three and nine months ended September 30, 2016 and 2015, respectively, the estimated research and development expenses for the Purchased Assets of $0.3 million and $0.8 million for the three and nine months ended September 30, 2016 and 2015, respectively, and the removal of non-recurring acquisition costs of $0.5 million for the three and nine months ended September 30, 2016. There was no adjustment to the total revenues. The unaudited pro forma information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the periods presented.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
(In thousands, except per share data)	(Unaudited)			
Operating loss	$(9,511)	$(15,151)	$(34,945)	$(40,519)
Net loss	(9,467)	(14,681)	(34,419)	(43,226)
Net loss per share, basic and diluted	$(0.84)	$(1.31)	$(3.07)	$(3.88)
Weighted average shares used to compute basic and diluted net loss per share	11,271	11,171	11,206	11,130

9. STOCK-BASED COMPENSATION

For periods prior to the spin-off, the Company’s stock-based compensation was derived from the equity awards granted by Integra to individuals who became the Company’s employees after the spin-off. As those stock-based compensation plans were Integra’s plans, the amounts have been recognized in the consolidated statements of operations and the Integra net investment account on the consolidated balance sheet. For periods after the spin-off, the Company's stock-based compensation has been recognized through the consolidated statement of operations and the Company's additional paid-in capital account on the consolidated balance sheet.

Equity Award Plans

As of June 30, 2015, Integra had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock units outstanding under three plans, the 2000 Equity Incentive Plan, the 2001 Equity Incentive Plan, and the 2003 Equity Incentive Plan. In connection with the spin-off, Integra equity awards granted to individuals who became employees of the Company were converted to SeaSpine equity awards. In general, each award is subject to the same terms and conditions as were in effect prior to the spin-off.

In May 2015, the Company adopted the 2015 Incentive Award Plan (the "2015 Plan"), under which the Company can grant its employees and non-employee directors incentive stock options and non-qualified stock options, restricted stock, performance stock, dividend equivalent rights, stock appreciation rights, stock payment awards and other incentive awards. The Company may issue up to 2,000,000 shares of its common stock under the 2015 Plan. On January 27, 2016, the Company's board of directors approved an amendment and restatement of the 2015 Plan, pursuant to which the share reserve was increased by

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300,000 shares over the original share reserve under the 2015 Plan, and on March 30, 2016, the board of directors approved an amendment and restatement of the 2015 Plan, pursuant to which the share reserve was increased by an additional 1,209,500 shares of common stock. Such amendments and restatements were approved by the stockholders of the Company on June 7, 2016. As a result, pursuant to the final amended and restated 2015 Plan (the "Restated Plan"), an aggregate of 1,509,500 additional shares are reserved for issuance under the Restated Plan relative to the share reserve under the 2015 Plan.

Restricted Stock Awards, Restricted Stock Units and Performance Stock Awards

Performance stock awards, restricted stock awards and restricted stock units generally have requisite service periods of three years. Performance stock awards are subject to graded vesting and the Company expenses their fair value over the requisite service period. The Company expenses the fair value of restricted stock awards and restricted stock units on an accelerated basis over the vesting period or requisite service period, whichever is shorter. Stock-based compensation expense related to restricted stock awards, restricted stock units and performance stock awards includes an estimate for forfeitures. The expected forfeiture rate of all equity-based compensation is based on historical experience of pre-vesting forfeitures on awards by each homogenous group of shareowners and is estimated to be 12% annually for all non-executive employees for the nine months ended September 30, 2016 and 10% annually for the nine months ended September 2015. There is no forfeiture rate applied for non-employee directors and executive employees as their pre-vesting forfeitures are anticipated to be highly unlikely. As individual grant awards become fully vested, stock-based compensation expense is adjusted to recognize actual forfeitures.

During the nine months ended September 30, 2016, the Company granted 75,075 shares of restricted stock awards, all of which were granted to non-employee directors. As of September 30, 2016, there was approximately $0.4 million of total unrecognized compensation expense related to unvested awards. This cost is expected to be recognized over a weighted-average period of approximately one year.

Stock Options

Stock option grants to employees generally have requisite service periods of four years, and stock option grants to non-employee directors generally have a requisite service period of one year. Both are subject to graded vesting. The Company records stock-based compensation expense associated with stock options on an accelerated basis over the various vesting periods within each grant and based on their fair value at the date of grant using the Black-Scholes-Merton option pricing model. The following weighted-average assumptions were used in the calculation of fair value for options grants for the three and nine months ended September 30, 2016, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Expected dividend yield	0 %	0 %	0 %	0 %
Risk-free interest rate	1.1 %	1.6 %	1.3 %	1.6 %
Expected volatility	38.1%	35.3%	38.3%	35.3%
Expected term (in years)	5.1	5.3	4.9	5.3

The Company considered that it has never paid cash dividends and does not currently intend to pay cash dividends. The risk-free interest rates are derived from the U.S. Treasury yield curve in effect on the date of grant for instruments with a remaining term similar to the expected term of the options. Due to the Company’s limited historical data, the expected volatility is calculated based upon the historical volatility of comparable companies in the medical device industry whose share prices are publicly available for a sufficient period of time. The expected term of "plain vanilla" options is calculated using the simplified method as prescribed by accounting guidance for stock-based compensation. A "plain vanilla" option is an option with the following characteristics: (1) the option is granted at-the-money; (2) exercisability is conditional only on satisfaction of a service condition through the vesting date; (3) employees who terminate their service prior to vesting forfeit the options; (4) employees who terminate their service after vesting are granted limited time to exercise their stock options; and (5) the options are nontransferable and non-hedgeable. The expected term of any other option is based on disclosures from similar companies with similar grants. In addition, the Company applies an expected forfeiture rate when amortizing stock-based compensation expense. The expected forfeiture rate of stock options is based on historical experience of pre-vesting forfeitures on awards by each homogenous group of shareowners and is estimated to be 12% annually for all non-executive employees for the nine months ended September 30, 2016, and 10% annually for the nine months ended September 30, 2015. There is no forfeiture rate applied for non-employee directors and executive employees as their pre-vesting forfeitures are anticipated to be highly unlikely. As individual grant awards become fully vested, stock-based compensation expense is adjusted to recognize actual forfeitures.

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There were 43,500 and 900,524 stock options granted during the three and nine months ended September 30, 2016, and 1,449,956 options granted during the three and nine months ended September 30, 2015.

As of September 30, 2016, there was approximately $3.5 million of total unrecognized compensation expense related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately 1.5 years.

Employee Stock Purchase Plan

In May 2015, the Company adopted a 2015 Employee Stock Purchase Plan, which was amended in December 2015 (as amended, the "ESPP"). Under the ESPP, eligible employees may purchase shares of the Company’s common stock through payroll deductions of up to 15% of eligible compensation during an offering period. Generally, each offering will be for a period of twenty-four months as determined by the Company's board of directors. There are four six-month purchase periods in each offering period for contributions to be made and to be converted into shares at the end of the purchase period. In no event may an employee purchase more than 2,500 shares per purchase period based on the closing price on the first trading date of an offering period or more than $25,000 worth of stock during each calendar year. The purchase price for shares to be purchased under the ESPP is 85% of the lesser of the market price of the Company's common stock on the first trading date of an offering period or any purchase date during an offering period (June 30 or December 31).

The ESPP authorizes the issuance of up to 400,000 shares of common stock pursuant to purchase rights granted to employees. The ESPP is intended to qualify as an “employee stock purchase plan” within the meaning of Section 423 of the Internal Revenue Code of 1986, as amended. The first offering period under the ESPP commenced on January 1, 2016 and will end on December 31, 2017. However, the ESPP contains a restart feature, such that if the market price of the stock at the end of any six-month purchase period is lower than the stock price at the original grant date of an offering period, that offering period will terminate after that purchase date, and a new two-year offering period will commence on the January 1 or July 1 immediately following the date the original offering period terminated. This restart feature was triggered by the purchase date that occurred on June 30, 2016, such that the offering period that commenced on January 1, 2016 was terminated, and a new offering period commenced on July 1, 2016 and will end on June 30, 2018. The Company applied share-based payment modification accounting to the awards that were initially valued at the grant date to determine the amount of any incremental fair value associated with the modified awards. The impact to stock-based compensation expense for modifications during the three and nine months ended September 30, 2016 was immaterial.

During the nine months ended September 30, 2016, 39,955 shares of common stock were purchased under the ESPP.

The Company estimates the fair value of shares issued to employees under the ESPP using the Black-Scholes-Merton option-pricing model. The following weighted average assumptions were used in the calculation of fair value of shares under the ESPP at the grant date for the three and nine months ended September 30, 2016:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
Expected dividend yield	0	%	0	%
Risk-free interest rate	0.5	%	0.6	%
Expected volatility	29.3	%	30.5	%
Expected term (in years)	1.2		1.2	

10. LEASES

The Company leases administrative, manufacturing, research, and distribution facilities and various manufacturing, office and transportation equipment through operating lease agreements. Future minimum lease payments under these operating leases at September 30, 2016 are as follows:

	Payments Due by Calendar Year (In thousands)
2016	$ 574
2017	2,185
2018	2,220
2019	2,262

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

2020	2,317
Thereafter	12,160
Total minimum lease payments	$21,718

Total rental expense for the three months ended September 30, 2016 and 2015 was $0.7 million and $0.5 million, respectively, and $2.3 million and $1.7 million for the nine months ended September 30, 2016 and 2015, respectively.

11. INCOME TAXES
The following table provides a summary of the Company's effective tax rate for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Reported tax rate	1.1%	1.9%	1.6%	(5.4)%

The Company reported a $0.3 million benefit from the change in realizable deferred tax assets of a foreign subsidiary for the three months ended September 30, 2015. The Company reported income tax expense for the nine months ended September 30, 2015 related to the taxable income generated by its U.S. subsidiary that was not part of the U.S. consolidated tax group as of September 30, 2015. As such, despite the reported losses before income taxes in those periods, the taxable income generated by such U.S. subsidiary was not allowed to be offset against the taxable losses generated by its other U.S. subsidiaries through August 31, 2015. Effective September 1, 2015, the Company made an election that will allow it to offset any future taxable losses generated by its U.S. subsidiaries against any future taxable income generated by its U.S. subsidiaries.

The Company reported an income tax benefit for the three and nine months ended September 30, 2016 which was primarily the result of a refund of tax initially paid toward the income tax return for our U.S. subsidiary which was not part of the U.S. consolidated tax group for the tax period January 1, 2015 through August 31, 2015. The Company also recorded a tax benefit related to the reversal of a liability recorded under ASC 740-10 due to the expiration of the statute of limitations. In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because we have concluded that it is more likely than not that the Company will be unable to realize the value of any resulting deferred tax assets. The Company will continue to assess its position in future periods to determine if it is appropriate to reduce a portion of its valuation allowance in the future.

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

12. COMMITMENTS AND CONTINGENCIES
In consideration for certain technology, manufacturing, distribution, and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on sales of certain products sold by the Company. The royalty

payments that the Company made under these agreements were included on the condensed consolidated statements of operations as a component of cost of goods sold.

The Company is subject to various claims, lawsuits and proceedings in the ordinary course of its business with respect to its products, its current or former employees, and involving commercial disputes, some of which have been settled by the Company. In the opinion of management, such claims are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to result in a material adverse effect on the Company's financial condition. However, it is possible that our results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

The Company accrues for loss contingencies when it is deemed probable that a loss has been incurred and that loss is estimable. The amounts accrued are based on the full amount of the estimated loss before considering insurance proceeds, and do not include an estimate for legal fees expected to be incurred in connection with the loss contingency. The Company accrues legal fees expected to be incurred in connection with loss contingencies as those fees are incurred by outside counsel as a period cost. The Company

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does not believe there are any pending legal proceedings that would have a material impact on the Company's financial position, cash flows or results of operations.

13. SEGMENT AND GEOGRAPHIC INFORMATION

Subsequent to the spin-off from Integra, management assessed its segment reporting based on how it internally manages and reports the results of its business to its chief operating decision maker. The Company's management reviews financial results, manages the business and allocates resources on an aggregate basis. Therefore, financial results are reported in a single operating segment: the development, manufacture and marketing of orthobiologics and spinal fusion hardware. The Company reports revenue in two product categories: orthobiologics and spinal fusion hardware. Orthobiologics products consist of a broad range of advanced and traditional bone graft substitutes that are designed to improve bone fusion rates following surgery. The spinal fusion hardware portfolio consists of an extensive line of products for minimally invasive surgery, complex spine, deformity and degenerative procedures.
Revenue, net consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Orthobiologics	$ 16,186			