

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

FORM 10-Q

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

For the quarterly period ended June 30, 2013

- 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
(State or other jurisdiction of
incorporation or organization)

77-0154833
(I.R.S. Employer
Identification No.)

1501 Industrial Road, San Carlos, CA 94070
(Address of principal executive offices) (Zip Code)

(650) 802-0400
(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 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 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 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

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

The number of issued and outstanding shares of the registrant's Common Stock, \$0.001 par value, as of August 2, 2013 was 30,745,831.

[Table of Contents](#)

NATUS MEDICAL INCORPORATED
TABLE OF CONTENTS

	<u>Page No.</u>
PART I. FINANCIAL INFORMATION	3
Item 1. Financial Statements	3
Condensed Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012 (unaudited)	3
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2013 and 2012 (unaudited)	4
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 (unaudited)	5
Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3. Quantitative and Qualitative Disclosures about Market Risk	25
Item 4. Controls and Procedures	26
PART II. OTHER INFORMATION	27
Item 1. Legal Proceedings	27
Item 1A. Risk Factors	27
Item 6. Exhibits	28
Signatures	29

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****NATUS MEDICAL INCORPORATED AND SUBSIDIARIES**
CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except share and per share amounts)

	<u>June 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 28,910	\$ 23,057
Accounts receivable, net of allowance for doubtful accounts of \$3,346 in 2013 and \$2,617 in 2012	87,557	89,960
Inventories	38,906	40,756
Prepaid expenses and other current assets	5,975	6,379
Deferred income tax	8,631	8,719
Total current assets	169,979	168,871
Property and equipment, net	25,842	26,512
Intangible assets	103,180	96,594
Goodwill	97,364	92,048
Other assets	8,445	7,828
Total assets	<u>\$404,810</u>	<u>\$ 391,853</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 25,811	\$ 32,537
Short-term borrowings	—	11,300
Current portion of long-term debt	10,182	8,526
Accrued liabilities	24,007	32,938
Deferred revenue	11,951	13,305
Total current liabilities	71,951	98,606
Long-term liabilities:		
Long-term debt, net of current portion	40,381	13,034
Other liabilities	3,779	3,038
Deferred income tax	9,341	8,423
Total liabilities	<u>125,452</u>	<u>123,101</u>
Stockholders' equity:		
Common Stock, \$0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 30,751,056 in 2013 and 30,106,933 in 2012	281,867	275,395
Retained earnings	19,101	11,638
Accumulated other comprehensive loss	(21,610)	(18,281)
Total stockholders' equity	<u>279,358</u>	<u>268,752</u>
Total liabilities and stockholders' equity	<u>\$404,810</u>	<u>\$ 391,853</u>

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

[Table of Contents](#)

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(unaudited)
(in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Revenue	\$82,250	\$61,032	\$168,084	\$120,440
Cost of revenue	<u>33,859</u>	<u>26,695</u>	<u>70,460</u>	<u>52,781</u>
Gross profit	<u>48,391</u>	<u>34,337</u>	<u>97,624</u>	<u>67,659</u>
Operating expenses:				
Marketing and selling	21,848	16,245	43,969	32,888
Research and development	8,626	6,585	16,801	13,331
General and administrative	<u>11,759</u>	<u>10,890</u>	<u>25,837</u>	<u>20,395</u>
Total operating expenses	<u>42,233</u>	<u>33,720</u>	<u>86,607</u>	<u>66,614</u>
Income from operations	6,158	617	11,017	1,045
Other income (expense), net	<u>(523)</u>	<u>297</u>	<u>(856)</u>	<u>477</u>
Income before provision for income tax	5,635	914	10,161	1,522
Provision for income tax expense	<u>1,615</u>	<u>590</u>	<u>2,699</u>	<u>909</u>
Net income	<u>\$ 4,020</u>	<u>\$ 324</u>	<u>\$ 7,462</u>	<u>\$ 613</u>
Foreign currency translation adjustment	<u>(998)</u>	<u>(2,371)</u>	<u>(3,329)</u>	<u>(1,960)</u>
Comprehensive income (loss)	<u>\$ 3,022</u>	<u>\$ (2,047)</u>	<u>\$ 4,133</u>	<u>\$ (1,347)</u>
Earnings per share:				
Basic	<u>\$ 0.14</u>	<u>\$ 0.01</u>	<u>\$ 0.25</u>	<u>\$ 0.02</u>
Diluted	<u>\$ 0.13</u>	<u>\$ 0.01</u>	<u>\$ 0.24</u>	<u>\$ 0.02</u>
Weighted average shares used in the calculation of earnings per share:				
Basic	<u>29,666</u>	<u>28,921</u>	<u>29,685</u>	<u>28,888</u>
Diluted	<u>30,468</u>	<u>29,697</u>	<u>30,470</u>	<u>29,610</u>

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

[Table of Contents](#)

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

	Six Months Ended June 30,	
	2013	2012
Operating activities:		
Net income	\$ 7,462	\$ 613
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,313	5,864
Provision for losses on accounts receivable	232	346
Warranty reserve	771	411
Loss on disposal of property and equipment	26	11
Share-based compensation	3,179	2,536
Excess tax (benefit) expense on the exercise of stock options	(403)	612
Changes in operating assets and liabilities:		
Accounts receivable	4,574	(3,891)
Inventories	(448)	6,638
Prepaid expenses and other assets	(112)	96
Accounts payable	(6,473)	(484)
Deferred income tax	(984)	(443)
Accrued liabilities and deferred revenue	(9,463)	1,773
Net cash provided by operating activities	<u>4,674</u>	<u>14,082</u>
Investing activities:		
Acquisition of businesses, net of cash acquired	(18,600)	(57,931)
Purchases of property and equipment	(1,514)	(2,297)
Purchase of intangible assets	(768)	—
Net cash used in investing activities	<u>(20,882)</u>	<u>(60,228)</u>
Financing activities:		
Proceeds from stock option exercises and ESPP purchases	3,847	770
Excess tax benefit (expense) on the exercise of stock options	403	(612)
Proceeds from short-term borrowings	—	6,000
Proceeds from long-term borrowings	55,300	25,000
Payments on borrowings	(37,586)	(93)
Net cash provided by financing activities	<u>21,964</u>	<u>31,065</u>
Exchange rate changes effect on cash and cash equivalents	97	(778)
Net increase (decrease) in cash and cash equivalents	5,853	(15,859)
Cash and cash equivalents, beginning of period	23,057	32,816
Cash and cash equivalents, end of period	<u>\$ 28,910</u>	<u>\$ 16,957</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 946	\$ 21
Cash paid for income taxes	\$ 7,527	\$ 2,865
Non-cash investing activities:		
Property and equipment included in accounts payable	\$ 268	\$ 415
Inventory transferred to property and equipment	\$ 719	\$ 1,001

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1 – Basis of Presentation

The accompanying interim condensed consolidated financial statements of Natus Medical Incorporated (“Natus,” “we,” “us,” “our,” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Except as noted below, the accounting policies followed in the preparation of the interim condensed consolidated financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Interim financial reports are prepared in accordance with the rules and regulations of the Securities and Exchange Commission; accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. The interim financial information is unaudited, but reflects all normal adjustments that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The condensed consolidated balance sheet as of December 31, 2012 was derived from audited financial statements, but does not include all disclosures required by GAAP. The accompanying financial statements should be read in conjunction with the financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Operating results for the six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Recent Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income—In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. (“ASU”) 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This topic requires us to provide information about the amounts reclassified out of accumulated other comprehensive income by component and the line items of net income to which significant amounts are reclassified. This topic is for annual and interim periods beginning after December 15, 2012. The update did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

2 – Business Combinations

Grass Technologies

On February 2, 2013, we completed an asset purchase of the Grass Technologies Product Group (“Grass”) from Astro-Med Inc. for a cash consideration of \$18.6 million. Grass manufactures and sells clinically differentiated neurodiagnostic and monitoring products, including a portfolio of electroencephalography (EEG) and polysomnography (PSG) systems for both clinical and research use and related accessories and proprietary electrodes. The acquisition strengthened the Company’s 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.

The Company has accounted for the acquisition as a business combination. Under the acquisition method of accounting, the assets acquired and liabilities assumed from Grass 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’s results of operations are included in the consolidated financial statements since February 2, 2013, the date of the acquisition.

Valuing certain components of the acquisition, primarily accounts receivable required us to make significant estimates that may be adjusted in the future; consequently, the purchase price allocation is considered preliminary. Final determination of these estimates could result in an adjustment to the preliminary purchase price allocation, with an offsetting adjustment to goodwill. As of June 30, 2013, there have been no adjustments to the preliminary purchase price.

Table of Contents

Approximately \$5.2 million has been allocated to goodwill. Goodwill is calculated as the difference between the acquisition date fair value of the consideration transferred and the provisional values assigned to the assets acquired and liabilities assumed and represent primarily the expected synergies of combining the operations of the Company and the Grass business. None of 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 management determines that the value of goodwill has become impaired, we will incur an accounting charge for the amount of impairment during the fiscal quarter in which the determination is made.

Grass's revenue of \$3.7 million and \$5.9 million and income from operations of \$687,000 and \$1.0 million are included in our condensed consolidated statements of income and comprehensive income for the period from April 1, 2013 to June 30, 2013 and February 2, 2013 (acquisition date) to June 30, 2013, respectively.

Nicolet

We acquired the Nicolet neurodiagnostic business ("Nicolet") from CareFusion on July 2, 2012 pursuant to a Share and Acquisition Purchase Agreement. The Nicolet business develops clinically differentiated neurodiagnostic and monitoring products, including a portfolio of electroencephalography (EEG) and electromyography (EMG) systems and related accessories, as well as vascular and obstetric Doppler sensors and connectivity products. The acquisition strengthened the Company's existing neurology portfolio and provided new product categories. The acquisition also better positions the Company in international markets, as over 50 percent of the Nicolet business is in markets outside of the United States.

We acquired all of the outstanding common shares of CareFusion subsidiaries comprising the Nicolet business in the United States, Ireland, and the United Kingdom, and certain assets and liabilities of Nicolet sales divisions principally in China, Brazil, Germany, Italy, the Netherlands, and Spain for \$55.5 million. A total of \$3.3 million of direct costs associated with the acquisition were expensed as incurred and reported as a component of general and administrative expenses.

The acquisition has been accounted for as a business combination. Under the acquisition method of accounting, the assets acquired and liabilities assumed from Nicolet 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. Nicolet's results of operations are included in the consolidated financial statements since July 2, 2012, the date of the acquisition.

During the six months ending June 30, 2013, we recorded adjustments to the preliminary purchase price allocation for deferred taxes that resulted in a net increase to goodwill of \$256,000.

Pro forma financial information

The following unaudited pro forma information combining results of operations of the Company for the six months ended June 30, 2013 and 2012 are presented as if the acquisitions of Grass and Nicolet had occurred on January 1, 2012:

Unaudited Pro forma Financial Information (in thousands)

	Six Months Ended	
	June 30,	
	2013	2012
Revenue	\$169,089	\$179,238
Income from operations	\$ 12,464	\$ 2,484

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 dates 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.

Table of Contents

For purposes of preparing the unaudited pro forma financial information for the period January 1, 2013 through June 30, 2013, Grass's statement of operations for the period from January 1, 2013 to February 1, 2013 was combined with our consolidated statement of operations and comprehensive income (loss) for the six months ended June 30, 2013.

For purposes of preparing the unaudited pro forma financial information for the period January 1, 2012 through June 30, 2012, Grass's statement of operations and Nicolet's consolidated statement of revenue and direct expenses for the six months ended June 30, 2012 were combined with our consolidated statement of operations and comprehensive income (loss) for the six months ended June 30, 2012.

The unaudited pro forma consolidated results for the six month period ended June 30, 2013 reflect the historical information of Natus and Grass, adjusted for the following pre-tax amounts:

- Additional amortization expense of \$59,300 related to the fair value of identifiable intangible assets acquired;
- Decrease of depreciation expense of \$14,800 related to the fair value adjustment to property and equipment acquired;
- Decrease in general and administrative expense of \$624,000 related to the direct acquisition costs that were recorded in the unaudited pro forma financial information in the six months ended June 30, 2012.

The unaudited pro forma consolidated results for the six month period ended June 30, 2012 reflect the historical information of Natus, Grass and Nicolet, adjusted for the following pre-tax amounts:

- Elimination of Nicolet's historical intangible asset amortization expense of approximately \$423,000;
- Additional amortization expense related to Grass of \$356,000 and Nicolet of \$565,000 related to the fair value of identifiable intangible assets acquired;
- Decrease of Grass's depreciation expense of approximately \$89,000 and Nicolet's depreciation expense of approximately \$782,000 related to the fair value adjustment to property and equipment acquired;
- Increase in general and administrative expense relating to Grass's direct acquisition costs of approximately \$533,000 and Nicolet's direct acquisition costs of \$3.3 million;
- Increase in cost of goods sold relating to Nicolet's fair value inventory adjustments of \$571,000.

3 – Basic and Diluted Earnings Per Common Share

Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. Diluted earnings 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 unvested 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 unexercised options is greater than the average market price of the stock for the period.

For the three and six months ended June 30, 2013, common stock equivalents of 801,327 and 785,431 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 1,583,695 and 1,552,230 shares, respectively, were excluded from the calculation of diluted earnings per share because the exercise price of the underlying options was greater than the average market price of the stock for the period.

For the three and six months ended June 30, 2012, common stock equivalents of 776,433 and 721,978 shares, respectively were included in the weighted average shares outstanding used to calculate diluted earnings per share, while common stock equivalents of 1,797,145 and 2,047,286 shares, respectively, were excluded from the calculation of diluted earnings per share because the exercise price of the underlying options was greater than the average market price of the stock for the period.

[Table of Contents](#)

4 – Inventories

Inventories consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Raw materials and subassemblies	\$19,206	\$ 21,373
Work in process	3,214	3,085
Finished goods	20,907	19,795
Total inventories	43,327	44,253
Less: Non-current inventories	(4,421)	(3,497)
Inventories, current	<u>\$38,906</u>	<u>\$ 40,756</u>

At June 30, 2013 and December 31, 2012, the Company has classified \$4.4 million and \$3.5 million of inventories, respectively, as non-current. This inventory consists primarily of service components used to repair products pursuant to warranty obligations and extended service contracts, including service components for products we are not currently selling. Management believes that these inventories will be utilized for their intended purpose.

5 – Intangible Assets

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

	June 30, 2013				December 31, 2012			
	Gross Carrying Amount	Accumulated Impairment	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Impairment	Accumulated Amortization	Net Book Value
Intangible assets with definite lives:								
Technology	\$ 66,380	—	\$ (23,066)	\$ 43,314	\$ 63,880	—	\$ (20,901)	\$42,979
Customer related	32,148	—	(8,885)	23,263	26,948	—	(7,563)	19,385
Internally developed software	10,558	—	(4,554)	6,004	9,790	—	(4,045)	5,745
Patents	2,812	—	(1,986)	826	2,812	—	(1,925)	887
Backlog	724	—	(724)	—	724	—	(724)	—
Definite-lived intangible assets	112,622		(39,215)	73,407	104,154		(35,158)	68,996
Intangible assets with indefinite lives:								
Tradenames	33,770	(1,560)	—	32,210	30,778	(1,560)	—	29,218
Total Intangibles before translation	146,392	(1,560)	(39,215)	105,617	134,932	(1,560)	(35,158)	98,214
Translation	(2,854)	—	417	(2,437)	(1,864)	—	244	(1,620)
Total intangibles assets	<u>\$143,538</u>	<u>\$ (1,560)</u>	<u>\$ (38,798)</u>	<u>\$103,180</u>	<u>\$133,068</u>	<u>\$ (1,560)</u>	<u>\$ (34,914)</u>	<u>\$96,594</u>

Definite-lived intangible assets are amortized over their weighted average lives of 15 years for technology, 12 years for customer related intangibles, 7 years for internally developed software, and 14 years for patents. Intangible assets with indefinite lives are not subject to amortization.

Internally developed software consists of \$9.6 million relating to costs incurred for development of internal use computer software and \$943,000 for development of software to be sold.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Technology	\$1,096	\$ 670	\$2,165	\$1,541
Customer Related	678	393	1,322	896
Internally developed software	244	580	509	1,201
Patents	30	40	61	101
Total amortization	<u>\$2,048</u>	<u>\$ 1,683</u>	<u>\$4,057</u>	<u>\$3,739</u>

[Table of Contents](#)

Expected amortization expense related to amortizable intangible assets is as follows (in thousands):

Six months ending December 31, 2013	\$ 4,061
2014	7,849
2015	7,508
2016	6,674
2017	6,291
2018	6,120
Thereafter	<u>34,904</u>
Total expected amortization expense	<u>\$73,407</u>

6 – Goodwill

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

Gross Balance, December 31, 2012	\$112,048
Accumulated impairment losses	<u>(20,000)</u>
Balance net of impairment losses, December 31, 2012	92,048
Goodwill as a result of acquisitions	5,668
Foreign currency translation	<u>(352)</u>
Balance, June 30, 2013	<u>\$ 97,364</u>

7 – Property and Equipment, net

Property and equipment, net consist of the following (in thousands):

	<u>June 30,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Land	\$ 4,286	\$ 4,371
Buildings	11,009	11,422
Leasehold improvements	3,661	3,450
Office furniture and equipment	12,053	11,601
Computer software and hardware	11,106	10,114
Demonstration and loaned equipment	<u>11,203</u>	<u>11,505</u>
	53,318	52,463
Accumulated depreciation and amortization	<u>(27,476)</u>	<u>(25,951)</u>
Total	<u>\$ 25,842</u>	<u>\$ 26,512</u>

Depreciation and amortization expense of property and equipment was approximately \$1.2 and \$2.3 million for the three and six months ended June 30, 2013, respectively, and was approximately \$1.3 and \$2.2 million for the three and six months ended June 30, 2012, respectively.

8 – Reserve for Product Warranties

We provide a warranty on all medical device products that is generally one year in length. We also sell extended service agreements on our medical device products. 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 third-party vendors on a contract basis.

We have accrued a warranty reserve, included in accrued liabilities on the accompanying balance sheets, for the expected future costs of servicing products during the initial warranty period. We base the liability on actual warranty costs incurred to service those products. On new products, additions to the reserve are based on a combination of factors including the percentage of service department labor applied to warranty repairs, as well as actual service department costs, and other judgments, such as the degree to which the product incorporates new technology. The reserve is reduced as costs are incurred to honor existing warranty obligations.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$ 2,643	\$ 2,275	\$ 2,260	\$ 2,157
Acquisition warranty assumed	—	—	191	—
Warranty accrued for the period	115	195	771	411
Repairs for the period	(688)	(245)	(1,152)	(343)
Balance, end of period	<u>\$ 2,070</u>	<u>\$ 2,225</u>	<u>\$ 2,070</u>	<u>\$ 2,225</u>

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.

9 – Share-Based Compensation

At June 30, 2013, we have two active plans that give rise to share-based compensation, the 2011 Stock Awards Plan and the 2011 Employee Stock Purchase Plan. The terms of awards granted during the six months ended June 30, 2013 and our methods for determining grant-date fair value of the awards were consistent with those described in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Detail of share-based compensation expense is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cost of revenue	\$ 37	\$ 62	\$ 96	\$ 112
Marketing and sales	202	275	472	527
Research and development	124	108	241	213
General and administrative	1,456	933	2,370	1,684
Total	<u>\$ 1,819</u>	<u>\$ 1,378</u>	<u>\$ 3,179</u>	<u>\$ 2,536</u>

As of June 30, 2013, unrecognized compensation expense related to the unvested portion of our stock options and other stock awards was approximately \$16.5 million, which is expected to be recognized over a weighted average period of 3.1 years.

Stock Options

Activity in our stock options during the six months ended June 30, 2013 is as follows:

	Shares	Weighted Average Exercise Price	Weighted- average remaining contractual life (years)	Aggregate intrinsic value (\$ 000's)
Outstanding, beginning of period	3,882,239	\$ 11.71		
Granted	615,620	\$ 14.10		
Exercised	(419,285)	\$ 7.87		
Cancelled	(419,305)	\$ 16.02		
Outstanding, end of period	<u>3,659,269</u>	\$ 12.06	4.0	\$ 9,811
Exercisable, end of period	<u>2,383,650</u>	\$ 11.38	2.0	\$ 8,445
Vested and expected to vest, end of period	<u>3,455,975</u>	\$ 11.99	3.75	\$ 9,608

The intrinsic value of options exercised during the six months ended June 30, 2013 was \$2.4 million.

Table of Contents

Restricted Stock Awards

Activity in our restricted stock awards (“RSAs”) during the six months ended June 30, 2013 is as follows:

	Shares	Weighted-average grant date fair value	Remaining cost expected to be recognized (\$ 000's)
Unvested, beginning of period	690,890	\$ 13.04	
Granted	305,780	\$ 14.08	
Vested	(77,250)	\$ 12.54	
Forfeited	(122,970)	\$ 12.83	
Unvested, end of period	<u>796,450</u>	\$ 13.52	\$ 10,253

We award restricted stock awards to U.S. employees of the Company that vest 50% upon the second anniversary of the vesting start date and 25% upon each of the third and fourth anniversaries of the vesting start date. We also award RSA's to non-employee directors of the Company that vest on the first anniversary of the grant date.

At June 30, 2013 the fair market value of outstanding RSAs was \$10.9 million and the weighted average remaining recognition period of unvested RSAs was 2.7 years. At December 31, 2012 the fair market value of outstanding RSAs was \$7.7 million and the weighted average remaining recognition period was 2.6 years. The intrinsic value of RSAs equals their fair market value.

Restricted Stock Units

Activity in our restricted stock units (“RSUs”) during the six months ended June 30, 2013 is as follows:

	Shares	Weighted-average remaining contractual life (years)	Aggregate intrinsic value (\$ 000's)
Outstanding, beginning of period	50,050		
Awarded	30,890		
Released	(475)		
Forfeited	—		
Outstanding, end of period	<u>80,465</u>	1.71	\$ 1,098

We award restricted stock units to non-U.S. employees of the Company that vest 50% upon the second anniversary of the vesting start date and 25% upon each of the third and fourth anniversaries of the vesting start date.

At June 30, 2013 the aggregate intrinsic value of outstanding RSUs was \$1.1 million and the weighted average remaining recognition period for unvested RSUs was 2.9 years. At December 31, 2012 the aggregate intrinsic value of outstanding RSUs was \$559,000 and the weighted average remaining recognition period for unvested RSUs was 2.8 years.

10 – Other income (expense), net

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Investment income	\$ 34	\$ 4	\$ 65	\$ 9
Interest expense	(469)	(8)	(946)	(16)
Foreign currency exchange gain (loss)	147	96	(50)	356
Other	(235)	205	75	128
Total other income (expense), net	<u>\$ (523)</u>	<u>\$ 297</u>	<u>\$ (856)</u>	<u>\$ 477</u>

[Table of Contents](#)

11 – Income Taxes

Provision for Income Tax Expense

We recorded provisions for income tax of \$1.6 and \$2.7 million for the three and six months ended June 30, 2013, respectively. Our effective tax rate was 28.9% and 26.7% for the three and six months ended June 30, 2013, respectively.

We recorded provisions for income tax of \$590,000 and \$909,000 for the three and six months ended June 30, 2012, respectively. Our effective tax rate was 64.6% and 59.7% for the three and six months ended June 30, 2012, respectively.

Our effective tax rate for the six months ended June 30, 2013 differed from statutory tax rates primarily because of profits taxed in foreign jurisdictions with lower tax rates than the statutory rate and tax benefits related to the 2012 federal research and development tax credit by enactment of the American Taxpayer Relief Act of 2012 in January 2013 and domestic manufacturer deduction. The federal research and development credit and domestic manufacturer deduction benefited the effective tax rate for the six month period ended June 30, 2013 by approximately 4%.

Our effective tax rate for the six months ended June 30, 2012 differed from statutory tax rates primarily due to losses in one foreign jurisdiction for which we did not record a tax benefit.

There was an insignificant increase of unrecognized tax benefits for the six months ended June 30, 2013. Within the next twelve months it is possible our uncertain tax benefit may change within a range of approximately zero to \$600,000. This change may impact the future effective tax rate and is a result of a lapse of statute of limitations, provided that no taxing authority conducts an examination.

Our tax returns remain open to examination as follows: U.S. Federal, 2009 through 2012, U.S. States 2008 through 2012 and significant foreign jurisdictions, 2009 through 2012.

12 – Restructuring Reserves

In January 2011, we adopted a reorganization plan that was designed to improve efficiencies in the operations of Medix, which we acquired in October 2010. During the three months ended September 30, 2011 we also initiated similar restructuring activities in Embla, which we acquired in September 2011. These restructuring activities were completed as of March 31, 2013.

In July 2012, we initiated an integration and reorganization plan related to the acquisition of Nicolet that is designed to eliminate redundant costs, improve efficiencies in operations, and to move to an indirect sales model in certain countries in Europe, where Nicolet had previously sold under a direct sales model. As a result of the Nicolet acquisition, we also initiated additional restructuring activities in Xltek. Substantially all of the costs associated with the integration and reorganization plan are associated with employee severance costs. Substantially all of the staff reductions were completed by March 31, 2013.

In January 2013, we adopted reorganization plans that are designed to continue to improve efficiencies in our operating units in Europe and Medix. These plans were further expanded during the second quarter of 2013 to include North America.

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

Activity in the restructuring reserves for these plans for the six months ended June 30, 2013 is as follows (in thousands):

	<u>2011 Plans</u>	<u>July 2012 Plan</u>	<u>2013 Plans</u>	<u>Totals</u>
Balances at December 31, 2012	\$ 83	\$ 2,662	\$ —	\$ 2,745
Expensed	4	211	1,208	1,423
Cash payments	(71)	(1,272)	(615)	(1,958)
Accrual reversal	(16)	(1,325)	—	(1,341)
Balances at June 30, 2013	<u>\$—</u>	<u>\$ 276</u>	<u>\$ 593</u>	<u>\$ 869</u>

[Table of Contents](#)

13 – Debt and Credit Arrangements

At June 30, 2013 the Company had a \$75 million credit facility consisting of a \$25 million revolving credit line and a \$50 million 5-year term loan with Wells Fargo Bank, National Association (“Wells Fargo”). The credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events, and the occurrence of a material adverse effect, and restricts our ability to pay dividends. We are in compliance with all covenants as of June 30, 2013. We have granted Wells Fargo a security interest in substantially all of our assets. We have no other significant credit facilities.

During the first quarter 2013 we borrowed \$22 million under the credit facility principally to fund the Grass acquisition and to provide for other working capital needs. We had no additional borrowings in the second quarter.

The credit facility was increased to \$75 million in June 2013 and the term was extended to five years. As part of the amended credit facility in June 2013, we converted \$31.2 million of short-term revolving debt to a term loan, increasing the term loan from \$18.8 million as of March 31, 2013 to \$50 million as of June 30, 2013.

Long-term debt is comprised of the following (2013 and 2012 columns in thousands):

	June 30, 2013	December 31, 2012
Term loan \$50 million, interest at LIBOR plus 1.75%, due September 30, 2018 with term loan principle repayable in quarterly installments of \$2.5 million	\$ 49,966	\$ 20,834
Term loan \$2.9 million Canadian (“CAD”), interest at cost of funds plus 2.5%, due September 15, 2014 with principle repayable in monthly installments of \$16,000 until August 15, 2014 and one final payment of \$404,000 collateralized by a first lien on company owned land and building	597	726
Total	50,563	21,560
Less current portion of long-term debt	(10,182)	(8,526)
Total long-term debt	\$ 40,381	\$ 13,034

Maturities of long-term debt as of June 30, 2013 are as follows (in thousands):

Six months ended December 31, 2013	\$ 5,091
2014	10,501
2015	10,000
2016	10,000
2017	10,000
2018	4,971
Total	\$50,563

At June 30, 2013 and December 31, 2012, the carrying value of total debt approximates fair market value. The fair value of the Company’s debt is considered a Level 2 measurement.

14 – Segment, Customer and Geographic Information

We operate in one reportable segment in which we provide healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments.

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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Consolidated Revenue:				
United States	\$47,935	\$34,145	\$ 96,245	\$ 64,484
Foreign countries	34,315	26,887	71,839	55,956
Totals	\$82,250	\$61,032	\$168,084	\$120,440

[Table of Contents](#)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Revenue by End Market:				
Neurology Products				
Devices and Systems	\$31,146	\$20,230	\$ 65,906	\$ 39,997
Supplies	15,234	9,109	30,680	16,730
Services	6,398	851	11,951	1,861
Total Neurology Revenue	<u>52,778</u>	<u>30,190</u>	<u>108,537</u>	<u>58,588</u>
Newborn Care Products				
Devices and Systems	15,911	18,528	33,105	37,983
Supplies	11,670	11,235	23,138	21,886
Services	1,891	1,079	3,304	1,983
Total Newborn Care Revenue	<u>29,472</u>	<u>30,842</u>	<u>59,547</u>	<u>61,852</u>
Total Revenue	<u>\$82,250</u>	<u>\$61,032</u>	<u>\$168,084</u>	<u>\$120,440</u>

	June 30, 2013	December 31, 2012
Long-lived assets:		
United States	\$10,510	\$ 9,813
Foreign countries	15,332	16,699
Totals	<u>\$25,842</u>	<u>\$ 26,512</u>

Long-lived assets consist principally of property and equipment, net of accumulated depreciation and amortization. During the three and six months ended June 30, 2013 and 2012, no single customer or foreign country contributed to more than 10% of revenue.

15 – 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.

Table of Contents

The fair value of our assets and liabilities subject to fair value measurements are as follows (in thousands):

	Fair Value as of 6/30/13	Fair Value Measurements as of 6/30/13 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 1,148	—	\$ 1,148	—
Total	\$ 1,148	—	\$ 1,148	—

	Fair Value as of 12/31/12	Fair Value Measurements as of 12/31/12 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	\$ 1,148	—	\$ 1,148	—
Total	\$ 1,148	—	\$ 1,148	—

The carrying amount of the Company's long term debt approximates fair value based on Level 2 inputs since the debt carries a variable interest rate that is tied to the current LIBOR rate plus a spread.

Non-financial assets such as goodwill, intangible assets, and property, plant, and equipment are evaluated for impairment and adjusted to fair value using Level 3 inputs, only when impairment is recognized. Fair values are considered Level 3 when management makes significant assumptions in developing a discounted cash flow model based upon a number of considerations including projections of revenues, earnings and a discount rate. In addition, in evaluating the fair value of goodwill impairment, further corroboration is obtained using our market capitalization. No impairment was recorded in the first six months of 2013 and 2012.

16 – Immaterial Corrections to Prior Period Financial Statements

Certain amounts previously reported in the condensed consolidated statements of operations and comprehensive income (loss) and condensed statements of cash flows for the three and six month periods ended June 30, 2012 have been restated to reflect the correction of immaterial errors as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The errors were related primarily to purchase accounting adjustments. In addition, certain other errors related to the liability associated with product trade-ins, currency loss on translation of foreign debt, amortization of intangible assets, the tax benefit associated with the release of accruals for uncertain tax positions were identified and corrected. The errors are not material individually or in the aggregate.

A summary of the effects of the correction of these errors on our condensed consolidated financial statements for the three and six month periods ended June 30, 2012 are presented in the table below (in thousands):

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	As Previously Reported	As Corrected	As Previously Reported	As Corrected
Condensed Consolidated Statements of Operations and Comprehensive Income				
Revenue	\$61,013	\$61,032	\$120,522	\$120,440
Cost of revenue	26,771	26,695	52,812	52,781
Gross profit	34,242	34,337	67,710	67,659
Income from operations	805	617	966	1,045
Income before provision for income tax	1,090	914	1,420	1,522
Net income	445	324	803	613
Basic earnings per share	\$ 0.02	\$ 0.01	\$ 0.03	\$ 0.02
Condensed Consolidated Statements of Cash Flows				
Net income			\$ 803	\$ 613
Depreciation and amortization			6,050	5,864
Change in operating assets and liabilities				
Inventories			6,615	6,638
Deferred income tax			(1,098)	(443)
Accrued liabilities and deferred revenue			2,054	1,773
Net cash provided by operating activities			14,061	14,082
Exchange rate changes effect on cash and cash equivalents			(757)	(778)

[Table of Contents](#)

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Registered Trademarks and Tradenames

Natus®, *AABR®*, *ABaer®*, *ALGO®*, *AOAE®*, *AuDX®* *Aura®*, *Balance Manager®*, *Balance Master®*, *Balance Shape®*, *Biliband®*, *Biologic®*, *Bo-JECT®*, *Brain Atlas®*, *Ceegraph®*, *CHAMP®*, *Clarity System®*, *Cochlea Scan®*, *Cool Cap®*, *CoolCare®*, *Comet®*, *Dantec®*, *Ear Couplers®*, *Ear Muffin®*, *EC2®*, *Echo Screen®*, *Embla US®*, *Embletta®*, *Enterprise®*, *EquiTest®*, *Fass®*, *Fischer-Zoth®*, *Flexicoupler®*, *Grass®*, *Grass Technologies®*, *Gumdrop®*, *Halo Ear Muffin®*, *Hawaii Medical®*, *Keypoint®*, *Keypoint AU®*, *Keypoint EU®*, *Keypoint JP®*, *MASTER®*, *Medelec®*, *Medix®*, *Medix.I.C.S.A®*, *Navigator®*, *Neatnick®*, *neoBLUE®*, *Neurocom®*, *Neuromax®*, *Neurotrac®*, *NeuroWorks®*, *Nicolet®*, *NicoletElite®*, *Oxydome®*, *Panorama®*, *Pocket®*, *Polyview®*, *REMBRANDT®*, *REMlogic®*, *Sandman®*, *Scout®*, *Sleeprite®*, *Sleepscan®*, *Sleeptrek®*, *Smart Scale®*, *Sonamed®*, *Sonara®*, *Sonara TEK®*, *Stellate Notta®*, *STETHODOP®*, *SZAC®*, *TECA®*, *Tootsweet®*, *Traveler®*, *Treetip®*, *Twin®*, *VAC PAC®*, *VERSALAB®*, *Warmette®*, *Xact Trace®*, *Xltek®* are registered trademarks of *Natus Medical Incorporated* and its subsidiaries. *Accuscreen™*, *Bili Lite Pad™*, *Bili-Lite™*, *Biomark™*, *Circumstraint™*, *Coherence™*, *Deltamed™*, *inVision™*, *Medix MediLED™*, *MiniMuffs™*, *NatalCare™*, *Neometrics™* and *Smartpack™* are non-registered trademarks of *Natus* and its subsidiaries. *Solutions for Newborn CareSM* is a non-registered service mark of *Natus*.

Overview

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) supplements the MD&A in the Annual Report on Form 10-K for the year ended December 31, 2012 of *Natus Medical Incorporated*. Management’s discussion and analysis should be read in conjunction with our condensed consolidated financial statements and accompanying footnotes, the discussion of certain risks and uncertainties contained in Part II, Item 1A of this report, our Annual Report filed on Form 10K for the year ended December 31, 2012 and the cautionary information regarding forward-looking statements at the end of this section. MD&A includes the following sections:

- **Our Business.** A general description of our business;
- **2013 Second Quarter Overview.** A summary of key information concerning the financial results for the three months ended June 30, 2013;
- **Application of Critical Accounting Policies.** A discussion of the accounting policies that are most important to the portrayal of our financial condition and results of operations and that require significant estimates, assumptions, and judgments;
- **Results of Operations.** An analysis of our results of operations for the periods presented in the financial statements;
- **Liquidity and Capital Resources.** An analysis of capital resources, sources and uses of cash, investing and financing activities, off-balance sheet arrangements, contractual obligations and interest rate hedging;
- **Recent Accounting Pronouncements.** See Note 1 to our Condensed Consolidated Financial Statements for a discussion of new accounting pronouncements that affect us; and
- **Cautionary Information Regarding Forward-Looking Statements.** Cautionary information about forward-looking statements.

Our Business

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.

[Table of Contents](#)

End Markets

Our products address two primary end markets:

- Neurology – Includes products for diagnostic electroencephalography (EEG), electromyography (EMG), intra-operative monitoring (IOM), diagnostic sleep analysis, or polysomnography (PSG), newborn brain monitoring, and assessment of balance and mobility disorders.
- Newborn Care – Includes thermoregulation devices and products for the treatment of brain injury and jaundice in newborns and products for newborn hearing screening and diagnostic hearing assessment.

Segment and Geographic Information

We operate in one reportable segment in which we provide healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments.

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.

Information regarding our sales and long-lived assets in the U.S. and in countries outside the U.S. is contained in Note 14 – *Segment, Customer and Geographic Information* of our condensed consolidated financial statements included in this report.

Revenue by Product Category

We generate our revenue either from sales of Devices and Systems, which are generally non-recurring, and from related Supplies and Services, which are generally recurring. The products that are attributable to these categories are described in our Annual Report on Form 10-K for the year ended December 31, 2012. Revenue from Devices and Systems, Supplies and Services, as a percent of total revenue for the three and six months ended June 30, 2013 and 2012 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Devices and Systems	57%	64%	59%	65%
Supplies	33%	33%	32%	32%
Services	10%	3%	9%	3%
Total	100%	100%	100%	100%

During the three and six months ended June 30, 2013 and 2012, no single customer or foreign country contributed to more than 10% of revenue.

2013 Second Quarter Overview

Our business and operating results are driven in part by worldwide economic conditions. Our sales are significantly dependent on both capital spending by hospitals in the United States and healthcare spending by ministries of health within the European Union.

Our consolidated revenue increased \$21.2 million in the second quarter ended June 30, 2013 to \$82.2 million compared to \$61.0 million in the second quarter of the previous year. Grass contributed to \$3.7 million of revenue and Nicolet contributed to \$21.2 million of revenue in the second quarter of 2013. We experienced revenue increases across business units in Canada and declines across other business units in Europe, South America and the United States.

Net income was \$4 million or \$0.13 per diluted share in the three months ended June 30, 2013, compared with net income of \$324,000 or \$0.01 per diluted share in the same period in 2012. An increase from 56.3% to 58.8% in gross profit percentage for the second quarter of 2013 compared to same period in 2012 resulted primarily from improved margins associated with more favorable product mix.

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.

[Table of Contents](#)

We believe that the following critical accounting policies require the use of significant estimates, assumptions, and judgments. The use of different estimates, assumptions, or 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
- Inventory is carried at the lower of cost or market value
- Carrying value of intangible assets and goodwill
- Liability for product warranties
- Share-based compensation

These critical accounting policies are described in more detail in our Annual Report on Form 10-K for the year ended December 31, 2012, under Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*. There have been no changes to these policies during the six months ended June 30, 2013.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue	100%	100%	100%	100%
Cost of revenue	41.2	43.7	41.9	43.8
Gross profit	58.8	56.3	58.1	56.2
Operating expenses:				
Marketing and selling	26.5	26.6	26.2	27.3
Research and development	10.5	10.8	10.0	11.1
General and administrative	14.3	17.9	15.4	16.9
Total operating expenses	51.3	55.3	51.6	55.3
Income from operations	7.5	1.0	6.5	0.9
Other income (expense), net	(0.6)	0.5	(0.5)	0.4
Income before provision for income tax	6.9	1.5	6.0	1.3
Provision for income tax	2.0	1.0	1.6	0.8
Net income	4.9%	0.5%	4.4%	0.5%

As the operations of Grass and Nicolet have been reflected in our consolidated results since their acquisition dates of February 2013 and July 2012, where significant, we have noted the impact of these acquisitions on our results of operations for the three and six months ended June 30, 2013, as compared to the same periods in 2012.

The following discussion reflects the effects of the corrections disclosed in Note 16 to the condensed consolidated financial statements.

Three Months Ended June 30, 2013 and 2012

Revenues

Our consolidated revenue increased by \$21.2 million or 35% to \$82.2 million for the three months ended June 30, 2013, compared to \$61.0 million in the comparable 2012 period. The increase was attributable to our recent acquisitions. Grass, acquired in February 2013 contributed \$3.7 million of revenue in the second quarter of 2013. Nicolet, acquired in July 2012 contributed \$21.2 million of revenue in the second quarter of 2013. Revenue from our products other than Grass and Nicolet decreased by \$3.7 million in 2013, compared to 2012, due in large part to our emphasizing the sale of the newly acquired products that serve the same markets as certain legacy products.

Table of Contents

Revenue from our neurology products increased \$22.6 million or 75% to \$52.8 million in the second quarter of 2013, compared to \$30.2 million in the same period in 2012. Revenue from our neurology products, other than Grass and Nicolet products, decreased by \$2.3 million for the three months ended June 30, 2013 compared to 2012. This decline was attributable to weak economic conditions in Europe coupled with a decline in domestic hospital capital spending and our emphasizing the sales of our newly acquired neurology products. Revenue from our newborn care products decreased by \$1.3 million, or 4% to \$29.5 million in the second quarter of 2013 compared to \$30.8 million in the same period in 2012. This decline was primarily attributed to lower sales of newborn care devices and systems partially offset by an increase in newborn care supplies and services.

Revenue from neurology devices and systems was \$31.1 million for the three months ended June 30, 2013, representing an increase of 54% or \$10.9 million, from \$20.2 million reported in the second quarter of 2012. Grass and Nicolet contributed to \$12.9 million of the increase in neurology devices and systems while revenue from our neurology products other than Grass and Nicolet decreased by \$2 million in the second quarter of 2013 compared to the second quarter of 2012, primarily attributable to a decrease in EMG revenue. Revenue from newborn care and other devices and systems was \$15.9 million for the three months ended June 30, 2013, representing a decrease of 14% or \$2.6 million, from \$18.5 million reported in the second quarter of 2012. This decline in newborn care devices and systems revenue was due to lower sales of diagnostic hearing, CFM and balance monitoring products.

Revenue from devices and systems was 57% of consolidated revenue in the second quarter of 2013 compared to 63% of consolidated revenue in the second quarter of 2012.

Revenue from neurology supplies was \$15.2 million for the three months ended June 30, 2013 representing an increase of 67% or \$6.1 million, from \$9.1 million reported in the second quarter of 2012. Grass and Nicolet contributed to \$8.9 million of neurology supplies. Neurology supplies revenue other than Grass and Nicolet, decreased by \$2.8 million in the second quarter of 2013 compared to the second quarter of 2012. This decline was primarily attributable to a decrease in Embla sleep supplies. Revenue from newborn care supplies was \$11.7 million for the three months ended June 30, 2013, representing an increase of 4% or \$500,000 from \$11.2 million reported in the second quarter of 2012. This increase was comprised primarily of an increase in newborn care supplies partially offset by a decrease in hearing supplies.

Revenue from supplies was 33% of consolidated revenue in both the second quarter of 2013 and 2012, respectively.

Revenue from neurology services was \$6.4 million for the three months ended June 30, 2013 representing an increase of 653% or \$5.6 million, from \$851,000 reported in the second quarter of 2012. Grass and Nicolet contributed to \$3.1 million of the increase in neurology services. Neurology services revenue other than Grass and Nicolet increased by \$2.5 million in the second quarter of 2013 compared to the second quarter of 2012. This increase was primarily attributable to Xltek service revenue. Revenue from newborn care services was \$1.9 million for the three months ended June 30, 2013, representing an increase of 73% or \$800,000 from \$1.1 million reported in the second quarter of 2012. This increase was comprised primarily of hearing, newborn care and balance service revenue.

Revenue from services was 10% of consolidated revenue in the second quarter of 2013 compared to 3% of consolidated revenue in the second quarter of 2012.

No single customer accounted for more than 10% of our revenue in either the second quarter of 2013 or 2012. Revenue from domestic sales increased 40% to \$47.9 million for the three months ended June 30, 2013 from \$34.1 million in the second quarter of 2012. Revenue from international sales increased 28% to \$34.3 million for the three months ended June 30, 2013 compared to \$26.9 million in the second quarter of 2012. Revenue from domestic sales was 58% of total revenue for the three months ended June 30, 2013 compared to 56% of total revenue in the second quarter of 2012, and revenue from international sales was 42% of total revenue in the second quarter of 2013 compared to 44% of total revenue in the second quarter of 2012.

Cost of Revenue and Gross Profit

Our cost of revenue increased \$7.2 million or 27% to \$33.9 million for the three months ended June 30, 2013 from \$26.7 million in the second quarter of 2012. Grass and Nicolet contributed \$9.7 million to our cost of revenue coupled with cost of revenue declines across North America. Gross profit increased \$14.1 million, or 41%, to \$48.4 million in the second quarter of 2013 from \$34.3 million in the second quarter of 2012 as a result of our improved margins associated with product mix. Gross profit as a percentage of revenue was 58.8% for the three months ended June 30, 2013 and 56.3% for the three months ending June 30, 2012. The increase in gross profit as a percentage of revenue was as the result of a higher percentage of sales of neurology products which generally carry higher margins than our other products.

Table of Contents

Operating Costs

Total operating costs increased \$8.5 million or 25% to \$42.2 million for the three months ended June 30, 2013, from \$33.7 million in the second quarter of 2012. The operating costs of Grass and Nicolet contributed to \$8.5 million in operating costs.

Our marketing and selling expenses increased \$5.6 million or 34% to \$21.8 million in the second quarter of 2013, from \$16.2 million in the second quarter of 2012. Marketing and selling expenses as a percent of total revenue was 26.6% in both the second quarter of 2013 and 2012. The marketing and selling expenses of Grass and Nicolet and were \$5.6 million comprising the entire increase in marketing and selling expenses

Our research and development expenses increased \$2 million or 31% to \$8.6 million for the three months ended June 30, 2013 from \$6.6 million for the three months ended June 30, 2012. Research and development expenses as a percent of total revenue decreased to 10.5% in the second quarter of 2013 from 10.8% in the second quarter of 2012. The research and development expenses of Grass and Nicolet were \$2.3 million for the three months ended June 30, 2013, partially offset by lower employee compensation costs resulting from restructuring activities initiated in 2012.

Our general and administrative expenses increased \$900,000 or 8% to \$11.8 million for the three months ended June 30, 2013 from \$10.9 million for the three months ended June 30, 2012. General and administrative expenses as a percent of revenue decreased to 14.3% in the second quarter of 2013 from 17.8% in the second quarter of 2012. The general and administrative expense of Grass and Nicolet were \$623,000. The newly enacted medical device tax in 2013 accounted for \$1.2 million of general and administrative expenses for the three months ended June 30, 2013 offset by lower direct costs related to acquisitions.

Other Income (Expense), net

Other income (expense), net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income (expense), net of \$(523,000) for the three months ended June 30, 2013, compared to \$297,000 for the three months ended June 30, 2012. We reported \$147,000 of foreign currency exchange gains in the second quarter of 2013 versus \$96,000 of foreign exchange gains in the second quarter of 2012. Interest expense was \$469,000 for the three months ended June 30, 2013 compared to \$8,000 for the three months ended June 30, 2012 due primarily to additional borrowings to fund the Nicolet and Grass acquisitions.

Provision for Income Tax

We recorded a provision for income tax of \$1.6 million and \$590,000 for the three months ended June 30, 2013 and 2012, respectively. The increase in tax expense for the three months ended June 30, 2013 compared to the same period of 2012 is primarily attributable to the increase in income before provision for income taxes. Our effective tax rate was 28.7% and 64.6% for the three months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013, our effective rate differed from statutory tax rates primarily because of profits taxed in foreign jurisdictions with lower tax rates. For the three months ended June 30, 2012, our effective rate differed from statutory tax rates primarily due to discrete items coupled with losses in some foreign jurisdictions for which we did not record a tax benefit.

Six Months Ended June 30, 2013 and 2012

Revenues

Our consolidated revenue increased by \$47.7 million or 40% to \$168.1 million for the six months ended June 30, 2013, compared to \$120.4 million in the comparable 2012 period. The increase was attributable to our recent acquisitions. Grass, acquired in February 2013 contributed \$5.9 million of revenue in the six month period of 2013. Nicolet, acquired in July 2012 contributed \$46.2 million of revenue in the six month period of 2013. Revenue from our products other than Grass and Nicolet, decreased by \$4.4 million in 2013 compared to 2012. This decline was attributable to weak economic conditions in Europe coupled with a decline in domestic hospital capital spending and our emphasizing the sales of our newly acquired neurology products.

Revenue from our neurology products increased \$49.9 million or 85% to \$108.5 million in the six month period of 2013, compared to \$58.6 million in the same period in 2012. Revenue from our neurology products, other than Grass and Nicolet products, decreased by \$2.2 million for the six months ended June 30, 2013 compared to 2012. This decline was attributable to weak economic conditions in Europe and to our emphasizing the sales of our newly acquired neurology products. Revenue from our newborn care products decreased by \$2.4 million, or 4% to \$59.5 million in the six month period of 2013 compared to \$61.9 million in the same period in 2012. This decline was primarily attributed to lower sales of newborn care devices and systems partially offset by an increase in newborn care supplies and services.

Table of Contents

Revenue from neurology devices and systems was \$65.9 million for the six months ended June 30, 2013, representing an increase of 65% or \$25.9 million, from \$40 million reported in the six month period of 2012. Grass and Nicolet contributed to \$27.6 million of the increase in neurology devices and systems while revenue from our neurology products other than Grass and Nicolet decreased by \$1.7 million in the six month period of 2013 compared to the six month period of 2012, primarily attributable to a decrease in EMG systems revenue. Revenue from newborn care and other devices and systems was \$33.1 million for the six months ended June 30, 2013, representing a decrease of 13% or \$4.9 million, from \$38 million reported in the six month period of 2012. This decline in newborn care devices and systems revenue was due to lower sales of newborn incubators, CFM and diagnostic hearing revenue.

Revenue from devices and systems was 59% of consolidated revenue in the six month period of 2013 compared to 65% of consolidated revenue in the six month period of 2012.

Revenue from neurology supplies was \$30.7 million for the six months ended June 30, 2013 representing an increase of 84% or \$14 million, from \$16.7 million reported in the six month period of 2012. Grass and Nicolet contributed to \$17.8 million of neurology supplies revenue. Neurology supplies revenue other than Grass and Nicolet, decreased by \$3.8 million in the six month period of 2013 compared to the six month period of 2012. This decline was primarily attributable to a decrease in sleep supplies. Revenue from newborn care supplies was \$23.1 million for the six months ended June 30, 2013, representing an increase of 5% or \$1.2 million from \$21.9 million reported in the six month period of 2012. This increase was comprised primarily of newborn care supplies.

Revenue from supplies was 32% of consolidated revenue in both six month periods of 2013 and 2012, respectively.

Revenue from neurology services was \$12 million for the six months ended June 30, 2013 representing an increase of 531% or \$10.1 million, from \$1.9 million reported in the six month period of 2012. Grass and Nicolet contributed to \$6.3 million of the increase in neurology services. Neurology services revenue other than Grass and Nicolet, increased by \$3.8 million in the six month period of 2013 compared to the six month period of 2012. This increase was primarily attributable to an increase in Xltek neurology and Embla sleep services. Revenue from newborn care services was \$3.3 million for the six months ended June 30, 2013, representing an increase of 65% or \$1.3 million from \$2 million reported in the six month period of 2012. This increase was primarily attributable to an increase in hearing and balance service revenue.

Revenue from services was 9% of consolidated revenue in the six month period compared to 3% of consolidated revenue in the six month period of 2012.

No single customer accounted for more than 10% of our revenue in either the six month period of 2013 or 2012. Revenue from domestic sales increased 49% to \$96.2 million for the six months ended June 30, 2013 from \$64.5 million in the six month period of 2012. Revenue from international sales increased 28% to \$71.8 million for the six months ended June 30, 2013 compared to \$56 million in the six month period of 2012. Revenue from domestic sales was 57% of total revenue for the six months ended June 30, 2013 compared to 54% of consolidated revenue in the six month period of 2012, and revenue from international sales was 43% of total revenue in the six month period of 2013 compared to 46% of consolidated revenue in the six month period of 2012.

Cost of Revenue and Gross Profit

Our cost of revenue increased \$17.7 million or 34% to \$70.5 million for the six months ended June 30, 2013 from \$52.8 million in the six month period of 2012. Grass and Nicolet contributed \$20.8 million to our cost of revenue offset by declines in cost of revenue declines across North America. Gross profit increased \$30 million, or 44%, to \$97.6 million in the six month period of 2013 from \$67.7 million in the six month period of 2012 as a result of our increased sales. Gross profit as a percentage of revenue was 58.1% for the six months ended June 30, 2013 and 56.2% for the six months ending June 30, 2012 as a result of product mix, primarily as a result of a higher percentage of sales of neurology products which generally carry higher margins than our other products.

Operating Costs

Total operating costs increased \$20 million or 30% to \$86.6 million for the six months ended June 30, 2013, from \$66.6 million in the six month period of 2012. The operating expense of Grass and Nicolet contributed to \$18.6 million in operating costs. The newly enacted medical device tax in 2013 accounted for \$2.5 million of the increase in operating costs partially offset by lower severance and acquisition related direct costs.

Table of Contents

Our marketing and selling expenses increased \$11.1 million or 34% to \$44 million in the six month period of 2013, from \$32.9 million in the six month period of 2012. Marketing and selling expenses as a percent of total revenue decreased to 26.2% in the first six months of 2013 from 27.3% in the first six months of 2012. The marketing and selling expenses of Grass and Nicolet and was \$11 million and accounted for the entire increase in marketing and selling expenses.

Our research and development expenses increased \$3.5 million or 26% to \$16.8 million for the six months ended June 30, 2013 from \$13.3 million for the six months ended June 30, 2012. Research and development expenses as a percent of total revenue decreased to 10% in the six month period of 2013 from 11.1% in the in the six month period of 2012. The research and development expenses of Grass and Nicolet were \$4.2 million for the six months ended June 30, 2013, partially offset by lower employee compensation costs resulting from cost cutting activities initiated in 2012 in our other operations.

Our general and administrative expenses increased \$5.4 million or 26% to \$25.8 million for the six months ended June 30, 2013 from \$20.4 million for the six months ended June 30, 2012. General and administrative expenses as a percent of revenue decreased to 15.4% in the six month period of 2013 from 16.9% in the six month period of 2012. The general and administrative expense of Grass and Nicolet was \$3.3 million. The newly enacted medical device tax in 2013 accounted for \$2.5 million of the increase in general and administrative expenses.

Other Income (Expense), net

Other income (expense), net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income (expense), net of \$(856,000) for the six months ended June 30, 2013, compared to \$477,000 for the six months ended June 30, 2012. We reported \$50,000 of foreign currency exchange losses in the six month period of 2013 versus \$356,000 of foreign exchange gains in the six month period of 2012. Interest expense was \$946,000 for the six months ended June 30, 2013 compared to \$16,000 for the six months ended June 30, 2012 due primarily to borrowings to fund the Nicolet and Grass acquisitions.

Provision for Income Tax

We recorded a provision for income tax of \$2.7 million and \$909,000 for the six months ended June 30, 2013 and 2012, respectively. The increase in tax expense for the six months ended June 30, 2013 compared to the six month period of 2012 is primarily attributable to the increase in income before provision for income taxes. Our effective tax rate was 26.6% and 59.7% for the six months ended June 30, 2013 and 2012, respectively. For the six months ended June 30, 2013 our effective rate differed from statutory tax rates primarily because of profits taxed in foreign jurisdictions with lower tax rates than the statutory rate and tax benefits of approximately \$340,000 derived from the recognition of the 2012 federal research and development tax credit by enactment of the American Taxpayer Relief Act of 2012 in January 2013. For the six months ended June 30, 2012, our effective rate differed from statutory tax rates primarily due to discrete items coupled with losses in some foreign jurisdictions for which we did not record a tax benefit.

Liquidity and Capital Resources

As of June 30, 2013, we had cash and cash equivalents of \$28.9 million and working capital of \$98 million, compared with cash and cash equivalents of \$23.1 million and working capital of \$70.5 million as of December 31, 2012. The increase in working capital resulted primarily from refinancing \$11.3 million of short-term borrowings to long-term debt and a \$15.7 million reduction in accounts payable and accrued expenses.

As of June 30, 2013, we had cash and cash equivalents outside the U.S. in certain of our foreign operations of approximately \$13.2 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 are repatriated.

At June 30, 2013 the Company had a \$75 million credit facility consisting of a \$25 million revolving credit line and a \$50 million 5-year term loan with Wells Fargo Bank, National Association ("Wells Fargo"). The credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events, and the occurrence of a material adverse effect, and restricts our ability to pay dividends. We have granted Wells Fargo a security interest in substantially all of our assets. We have no other significant credit facilities.

Table of Contents

In February 2013, we acquired through an asset purchase for a cash price of \$18.6 million the Grass Technology Product Group from Astro-Med Inc. We funded this acquisition with a combination of cash-on-hand and an \$18 million borrowing under the credit facility.

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.

Cash provided by operations decreased by \$10 million to \$4 million for the six months ended June 30, 2013 compared to an increase of \$7.1 million for the same period in 2012. The sum of our net income and certain non-cash expense items, such as reserves, depreciation and amortization, and share based compensation was approximately \$17.6 million for the six months ended June 30, 2013, compared to \$10.5 million in the 2012. The overall impact of changes in certain operating assets and liabilities on total operating cash flows resulted in a cash outflow of \$12.5 million in the six months ended June 30, 2013 compared with a cash inflow of \$3.4 million in the 2012 period. In particular, our cash flow from operations in the six months of 2013 was negatively impacted by a \$9.5 million decrease in accrued expenses and deferred revenue, a \$6.5 million decrease in accounts payable partially offset by a \$4.6 million decrease in accounts receivable and \$6.8 million higher net income.

Cash used by investing activities was \$20.9 million for the six months ended June 30, 2013, compared to cash used by investing activities of \$60 million for the same period in 2012. We used \$18.6 million to acquire Grass during the six months ended June 30, 2013 and we used \$57.9 million to acquire Nicolet during the six months ended June 30, 2012. We used \$1.5 and \$2.3 million of cash to acquire property and equipment during the six months ended June 30, 2013 and 2012, respectively.

Cash provided by financing activities was \$22.6 million in the six months ended June 30, 2013, compared to cash \$31.1 million in the six months ended June 30, 2012. In February 2013 we borrowed \$18 million of cash on our credit facility to partially fund the acquisition of Grass and had additional short-term borrowings of \$4 million which we refinanced together with the \$5 million of short-term borrowings associated with the Nicolet acquisition in 2012 as long-term borrowings as of June 30, 2013. In June 2012 we borrowed \$31 million of cash on our credit facility to partially fund the acquisition of Nicolet for which \$8 million has been repaid. We received cash from sales of our stock pursuant to exercise of stock options and contributions to our employee stock purchase plan in the amount of \$3.8 million and \$770,000 in the six months ended June 30, 2013 and 2012, respectively.

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

- Extent to which we make acquisitions;
- Amount and timing of revenue;
- Extent to which our existing and new products gain market acceptance;
- 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.

Commitments and Contingencies

In the normal course of business, we enter into obligations and commitments that require future contractual payments. The commitments result primarily from firm, noncancellable purchase orders placed with contract vendors that manufacture some of the components used in our medical devices and related disposable supply products, as well as commitments for leased office, manufacturing, and warehouse facilities. The only material change to the table of contractual obligations presented in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, of our Annual Report on Form 10-K for the year ended December 31, 2012 has been the result of \$22 million of debt incurred from borrowings against the credit facility as of June 30, 2013.

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

[Table of Contents](#)

Recent Accounting Pronouncements

See Note 1 to our Condensed Consolidated Financial Statements for a discussion of new accounting pronouncements that affect us.

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 2 include, but are not limited to, statements regarding the following: our belief that the recovery from the worldwide economic downturn has continued, our expectation regarding expansion of our international operations, our expectations regarding our new products, 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, the use of debt to fund acquisitions, our expectations of earnout arrangements related to acquisitions, 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 Part II, 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.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We develop products in the U.S., Canada, Argentina, and Europe 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 U.S. Dollars and Euros and with the acquisitions of Xltek in 2007, Medix in 2010 and Nicolet in 2012, a small portion of our sales are now denominated in Canadian dollars, Argentine pesos and British pounds. As our sales in currencies other than the U.S. Dollar increase, our exposure to foreign currency fluctuations may increase.

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 six months ended June 30, 2013. 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 our investments held as of June 30, 2013.

When feasible, we invest excess cash in bank money-market funds or discrete short-term investments. The fair value of short-term investments and cash equivalents (“investments”) is sensitive to changes in the general level of interest rates in the U.S., and the fair value of these investments will fall if market interest rates increase. However, since we generally have the ability to hold the investments to maturity, these declines in fair value may never be realized. If market interest rates were to increase by 10% from levels at June 30, 2013, the fair value of our investments would decline by an immaterial amount.

All of the potential changes noted above are based on sensitivity analyses performed on our financial position as of June 30, 2013. 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.

[Table of Contents](#)

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer and with the participation of our disclosure committee, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2013. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SECs rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act 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. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of June 30, 2013 at the reasonable assurance level due to a material weakness that we identified as of December 31, 2012 that has not been remediated. The material weakness relates to our controls over the implementation of a single-platform enterprise resource planning (“ERP”) application for our operations in North America exclusive of Nicolet. In particular, we did not perform adequate user acceptance testing prior to implementing this application to identify processes that were later discovered to not operate as designed. This resulted in an inadequate segregation of duties and inadequate controls over approval of certain journal entries based on the roles assigned to users of the ERP. In addition, given the system implementation issues, we were not able to timely prepare account analyses and reconciliations.

These factors prevented us from completing our financial close and preparation of financial statements on a timely basis, which, in turn, made us unable to file our financial statements by the due date required by the applicable rules and regulations established by the Securities and Exchange Commission.

Management’s Remediation Activities

To remediate the material weakness in our internal control over financial reporting described above, we are developing and implementing new control procedures regarding our ongoing implementation of the ERP application, including the following: (i) devoting additional resources to fixing processes associated with the financial close that were not operating as designed, (ii) revising user roles to provide adequate separation of duties, appropriate approval levels, and review of manual transaction details, and (iii) developing detailed reports to facilitate accurate account analyses and timely reconciliation of accounts. However, the material weakness will not be considered remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded, through testing, that the controls are operating effectively.

Changes in Internal Control over Financial Reporting

Other than the actions taken as described above under “Management’s Remediation Activities,” there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, even if determined effective and no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives to prevent or detect misstatements. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs. 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.

PART II. OTHER INFORMATION

ITEM 1. 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. Our management reviews these matters if and when they arise and believes that the resolution of any such matters currently known will not have a material effect on our results of operations or financial position.

ITEM 1A. Risk Factors

A description of the risks associated with our business, financial condition and results of operations is set forth in Part 1, Item 1A “Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. There have been no material changes in our risks from such description.

Table of Contents

ITEM 6. Exhibits

(a) Exhibits

<u>Exhibit No.</u>	<u>Exhibit</u>	<u>Incorporated By Reference</u>			
		<u>Filing</u>	<u>Exhibit No.</u>	<u>File No.</u>	<u>File Date</u>
10.1*	Form of Employment Agreement between Natus Medical Incorporated and Jonathan A. Kennedy dated April 8, 2013				
10.2*	Amended Employment Agreement between the Company and James B. Hawkins dated April 19, 2013	8-K	99.1	000-33001	04/19/2013
10.3	Fourth Amended and restated Credit Agreement, dated as of June 28, 2013, between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	07/05/2013
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.LAB**	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document				
101.DEF**	XBRL Taxonomy Extension Definition Document				

* Indicates a management contract or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be "filed" for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or Exchange Act, except as may be expressly set forth by specific reference in such filings.

[Table of Contents](#)

SIGNATURES

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

NATUS MEDICAL INCORPORATED

Dated: August 8, 2013

By: /s/ James B. Hawkins

James B. Hawkins
Chief Executive Officer
(Principal Executive Officer)

Dated: August 8, 2013

By: /s/ Jonathan A. Kennedy

Jonathan A. Kennedy
Senior Vice President Finance and
Chief Financial Officer
(Principal Financial and
Accounting Officer)

[Table of Contents](#)

NATUS MEDICAL INCORPORATED
INDEX TO EXHIBITS

<u>Exhibit No.</u>	<u>Exhibit</u>	<u>Incorporated By Reference</u>			
		<u>Filing</u>	<u>Exhibit No.</u>	<u>File No.</u>	<u>File Date</u>
10.1*	Form of Employment Agreement between Natus Medical Incorporated and Jonathan A. Kennedy dated April 8, 2013				
10.2*	Amended Employment Agreement between the Company and James B. Hawkins dated April 19, 2013	8-K	99.1	000-33001	04/19/2013
10.3	Fourth Amended and restated Credit Agreement, dated as of June 28, 2013, between Natus Medical Incorporated and Wells Fargo Bank, National Association	8-K	10.1	000-33001	07/05/2013
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.LAB**	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document				
101.DEF**	XBRL Taxonomy Extension Definition Document				

* Indicates a management contract or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be “filed” for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or Exchange Act, except as may be expressly set forth by specific reference in such filings.

NATUS MEDICAL INCORPORATED
JONATHAN A. KENNEDY EMPLOYMENT AGREEMENT

This Agreement is entered into as of April 8, 2013 (the "Effective Date"), by and between Natus Medical, Incorporated ("Company"), and Jonathan A. Kennedy ("Employee").

1. Duties and Scope of Employment

(a) Positions and Duties. As of the Effective Date, Employee will serve as Chief Financial Officer ("CFO"). Employee will render such business and professional services in the performance of his duties, consistent with Employee's position within the Company, as shall reasonably be assigned to him by the Company's Chief Executive Officer ("CEO"). The period of Employee's employment under this Agreement is referred to herein as the "Employment Term."

(b) Obligations. During the Employment Term, Employee will perform his duties faithfully and to the best of his ability and will devote his full business efforts and time to the Company. For the duration of the Employment Term, Employee agrees not to actively engage in any other employment, occupation or consulting activity for any direct or indirect remuneration without the prior approval of the CEO.

2. At-Will Employment. The parties agree that Employee's employment with the Company will be "at-will" employment and may be terminated at any time with or without cause or notice. Employee understands and agrees that neither his job performance nor promotions, commendations, bonuses or the like from the Company give rise to or in any way serve as the basis for modification, amendment, or extension, by implication or otherwise, of his employment with the Company.

3. Compensation

(a) Base Salary. During the Employment Term, the Company will pay Employee an annual salary of \$340,000 as compensation for his services (the "Base Salary"). The Base Salary will be paid periodically in accordance with the Company's normal payroll practices and be subject to the usual, required withholding. Employee's salary will be subject to review and adjustments will be made based upon the Company's normal performance review practices.

(b) Performance Bonus. Employee shall be eligible to receive a cash bonus pursuant to the Company's Executive Management Incentive Plan of up to 65% (at 100%) of base salary, contingent on Company performance.

(c) Sign-on Bonus. In addition, the Company will offer a sign-on bonus in the amount of \$50,000 payable within 30 days of your start date.

(d) Equity Awards. Subject to approval by the Board of Directors, Employee shall receive the following equity awards: Employee shall receive options to purchase 100,000 shares of Company Common Stock Employee's, pursuant to and governed by the terms of the Company's 2011 Stock Awards Plan ("2011 Plan"), with an exercise price at the date of grant determined in accordance with the 2011 Plan. Vesting begins six (6) months from and is retroactive to Employee's start date. Stock vests at 1/48th per month. Notwithstanding any other provision of the Agreement, under no circumstances shall Employee have any right to exercise stock options before Employee has completed one-hundred-eighty-days of employment. Employee shall also receive 50,000 shares of restricted stock pursuant to and governed by the terms of the 2011 Plan, which shares shall vest at the rate of 50% on the second anniversary of the grant, 25% on the third anniversary of the grant, and the final 25% on the fourth anniversary of the grant. Employee shall be eligible for future equity awards commencing in 2013, as determined by the Company's Compensation Committee.

4. Employee Benefits. During the Employment Term, Employee will be entitled to participate in the employee benefit plans currently and hereafter maintained by the Company of general applicability to other employees of the Company, including, without limitation, the Company's group medical, dental, vision, disability, life insurance, and flexible-spending account plans consistent with the terms of such plans. The Company reserves the right to cancel or change the benefit plans and programs it offers to its employees at any time.

5. Paid Time Off (“PTO”). Employee is entitled to receive PTO pursuant to Natus’ standard benefit policy currently and hereafter maintained by the Company, and as may be cancelled or changed from time to time.

6. Expenses. The Company will reimburse Employee for reasonable travel, entertainment or other expenses incurred by Employee in the furtherance of or in connection with the performance of Employee’s duties hereunder, in accordance with the Company’s expense reimbursement policy as in effect from time to time.

7. Severance.

(a) Involuntary Termination. If Employee’s employment with the Company terminates other than for “Cause” (as defined herein), death or disability, and Employee signs and does not revoke a standard release of claims with the Company, then, subject to Section 11, Employee shall be entitled to (i) receive continuing payments of severance pay (less applicable withholding taxes) at a rate equal to his Base Salary rate, as then in effect, for a period equal to twelve (12) months from the date of Employee’s “separation from service” (as defined in Treas. Reg. 1.409A-1(h)) with the Company, to be paid periodically in accordance with the Company’s normal payroll policies and commencing with the latest payroll date that is also within seventy (70) days from the date of “separation from service” provided that the required release is effective on such date (with payments that would have been made on earlier payroll dates, but for this provision, cumulated and paid on such payroll date); (ii) the immediate vesting and exercisability of 100% of the shares subject to all of Executive’s stock options and restricted stock (whether currently outstanding or granted in following the Effective Date) outstanding on the date of such termination (the “Stock Options”) and (iii) continued payment by the Company of the group health continuation coverage premiums for Executive’s eligible dependents under Title X of the Consolidated Budget Reconciliation Act of 1985, as amended (“COBRA”) as in effect through the lesser of (x) twelve (12) months from the effective date of such termination, (y) the date upon which Executive and Executive’s eligible dependents become covered under similar plans, or (z) the date Executive no longer constitutes a “Qualified Beneficiary” (as such term is defined in Section 4980B(g) of the Internal Revenue Code of 1986, as amended (the “Code”)); provided, however, that Executive will be solely responsible for electing such coverage within the required time periods.

(b) Voluntary Termination: Termination for Cause. If Employee’s employment with the Company terminates voluntarily by Employee (other than as described in subsection (c) below) or for Cause by the Company or due to Employee’s death or disability, then (i) all vesting of Stock Options and restricted stock and restricted stock units will immediately cease, (ii) all payments of compensation by the Company to Employee hereunder will terminate immediately (except as to amounts already earned), and (iii) Employee will only be eligible for severance benefits, if any, in accordance with the Company’s established policies as then in effect.

(c) Change of Control Benefits. If within six (6) months following a “Change of Control” (as defined below) (i) Employee terminates Employee’s employment with the Company for Good Reason after providing the Company with written notice within the ninety (90) days after the occurrence of an event constituting Good Reason and an opportunity for the Company to cure such occurrence of not less than thirty (30) days, or (ii) the Company or the successor corporation terminates Employee’s employment with the Company for other than Cause, death or disability, then Employee shall be entitled to the benefits provided for in subsection (a). Employee shall only be permitted to receive the benefits provided for in subsection (a) once and shall not be permitted to claim such benefits under both subsection (a) and (c) such that Employee would receive the benefits pursuant to subsection (a) twice. The payment-characterization provisions made under subsection (a) above for purposes of Section 409A of the Code shall apply as well.

8. Limitation on Payments. In the event that the severance and other benefits provided for in this Agreement or otherwise payable to the Employee (i) constitute “parachute payments” within the meaning of Section 280G of the Code and (ii) but for this Section 8, would be subject to the excise tax imposed by Section 4999 of the Code, then the Employee’s severance benefits under Section 4(a)(i) shall be either:

- delivered in full, or
- delivered as to such lesser extent which would result in no portion of such severance benefits being subject to excise tax under Section 4999 of the Code,
- whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the excise tax imposed by Section 4999, results in the receipt by Employee on an after-tax basis, of the

greatest amount of severance benefits, notwithstanding that all or some portion of such severance benefits may be taxable under Section 4999 of the Code. Unless the Company and Employee otherwise agree in writing, any determination required under this Section 8 shall be made in writing by the Company's independent public accountants immediately prior to Change of Control (the "Accountants"), whose determination shall be conclusive and binding upon Employee and the Company for all purposes. For purposes of making the calculations required by this Section 8, the Accountants may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company and Employee shall furnish to the Accountants such information and documents as the Accountants may reasonably request in order to make a determination under this Section. The Company shall bear all costs the Accountants may reasonably incur in connection with any calculations contemplated by this Section 8. If payment is to be in a lesser amount then reduction shall occur in the following order: (i) reduction of payments of cash; and (ii) reduction in equity awards; and in each category reduction shall be pro rata between those payments subject to Section 409A and payments not subject to Section 409A.

9. Definitions.

(a) Cause. For purposes of this Agreement, "Cause" shall mean (i) any act of personal dishonesty taken by Employee in connection with his responsibilities as an employee and intended to result in substantial personal enrichment of Employee, (ii) Employee's conviction of a felony, (iii) a willful act by Employee which constitutes gross misconduct and which is injurious to the Company, or (iv) continued substantial violations by Employee of Employee's employment duties which are demonstrably willful and deliberate on Employee's part after there has been delivered to Employee a written demand for performance from the Company which specifically sets forth the factual basis for the Company's belief that Employee has not substantially performed Employee's duties.

(b) Change of Control. For purposes of this Agreement, "Change of Control" of the Company is defined as:

(i) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing 50% or more of the total voting power represented by the Company's then outstanding voting securities; or

(ii) a change in the composition of the Board occurring within a two-year period, as a result of which fewer than a majority of the directors are Incumbent Directors. "Incumbent Directors" will mean directors who either (A) are directors of the Company as of the date hereof, or (B) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or nomination (but will not include an individual whose election or nomination is in connection with an actual or threatened proxy contest relating to the election of directors to the Company); or

(iii) the date of the consummation of a merger or consolidation of the Company with any other corporation that has been approved by the stockholders of the Company, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than forty percent (40%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation, or the stockholders of the Company approve a plan of complete liquidation of the Company; or

(iv) the date of the consummation of the sale or disposition by the Company of all or substantially all the Company's assets.

(c) Good Reason. For purposes of this Agreement, "Good Reason" shall mean any of the following actions taken without the Employee's express written consent: (i) the material reduction of the Employee's duties or responsibilities relative to Employee's duties or responsibilities in effect immediately prior to such reduction; provided, however, that a reduction in duties or responsibilities solely by virtue of the Company being acquired and made part of a larger entity (as, for example, when the Chief Financial Officer of Natus Medical Incorporated remains as such following a Change of Control and is not made the Chief Financial Officer of the acquiring

corporation) shall not constitute “Good Reason;” (ii) a material reduction by the Company in Employee’s annual Base Salary as in effect immediately prior to such reduction; (iii) a material reduction by the Company in the kind or level of employee benefits to which Employee is entitled immediately prior to such reduction with the result that Employee’s overall benefits package is significantly reduced; (iv) the relocation of Employee’s primary place of work to a facility or a location that increases Employee’s commute distance by more than 35 miles from Employee’s then primary place of work ; or (v) the material breach of this Agreement by the Company (including, but not limited to, failure of the Company to obtain the assumption of this Agreement by any successors contemplated in Section 12).

10. Confidential Information. Employee agrees to enter into the Company’s standard Confidential Information and Invention Assignment Agreement (the “Confidential Information Agreement”) upon commencing employment hereunder.

11. Conditional Nature of Severance Payments.

(a) Noncompete. Employee acknowledges that the nature of the Company’s business is such that if Employee were to become employed by, or substantially involved in, the business of a competitor of the Company following the termination of Employee’s employment with the Company, it would be very difficult for Employee not to rely on or use the Company’s trade secrets and confidential information. Thus, to avoid the inevitable disclosure of the Company’s trade secrets and confidential information, Employee agrees and acknowledges that Employee’s right to receive the severance payments set forth in Section 7 (to the extent Employee is otherwise entitled to such payments) shall be conditioned upon Employee not directly or indirectly engaging in (whether as an employee, consultant, agent, proprietor, principal, partner, stockholder, corporate officer, director or otherwise), nor having any ownership interest in or participating in the financing, operation, management or control of, any person, firm, corporation or business that competes with Company or is a customer of the Company. Upon any breach of this section, all severance payments pursuant to this Agreement shall immediately cease.

(b) Non-Solicitation. Until the date eighteen (18) months after the termination of Employee’s employment with the Company for any reason, Employee agrees not, either directly or indirectly, to solicit, induce, attempt to hire, recruit, encourage, take away, hire any employee of the Company or cause an employee to leave his or her employment either for Employee or for any other entity or person. Additionally, Employee acknowledges that Employee’s right to receive the severance payments set forth in Section 7 (to the extent Employee is otherwise entitled to such payments) are contingent upon Employee complying with this Section 10(b) and upon any breach of this section all severance payments pursuant to this Agreement shall immediately cease.

(c) Understanding of Covenants. Employee represents that Employee (i) is familiar with the foregoing covenants not to compete and not to solicit, and (ii) is fully aware of Employee’s obligations hereunder, including, without limitation, the reasonableness of the length of time, scope and geographic coverage of these covenants.

12. Code Section 409A. For purposes of this Agreement, a termination of employment will be determined consistent with the rules relating to a “separation from service” as defined in Section 409A of the Code and the regulations thereunder (“Section 409A”). Notwithstanding anything else provided herein, to the extent any payments provided under this Agreement in connection with Employee’s termination of employment constitute deferred compensation subject to Section 409A, and Employee is deemed at the time of such termination of employment to be a “specified employee” under Section 409A, then such payment shall not be made or commence until the earlier of (i) the expiration of the 6-month period measured from Employee’s separation from service from the Company or (ii) the date of Employee’s death following such a separation from service; provided, however, that such deferral shall only be effected to the extent required to avoid adverse tax treatment to Employee including, without limitation, the additional tax for which Employee would otherwise be liable under Section 409A(a)(1)(B) in the absence of such a deferral. The first payment thereof will include a catch-up payment covering the amount that would have otherwise been paid during the period between Employee’s termination of employment and the first payment date but for the application of this provision, and the balance of the installments (if any) will be payable in accordance with their original schedule. To the extent that any provision of this Agreement is ambiguous as to its compliance with Section 409A, the provision will be read in such a manner so that all payments hereunder comply with Section 409A. To the extent any payment under this Agreement may be classified as a “short-term deferral” within the meaning of Section 409A, such payment shall be deemed a short-term deferral, even if it may also qualify for an exemption from Section 409A under another provision of Section 409A. Payments pursuant to this section

are intended to constitute separate payments for purposes of Section 1.409A-2(b)(2) of the Treasury Regulations. Except as otherwise expressly provided herein, to the extent any expense reimbursement or the provision of any in-kind benefit under this Agreement is determined to be subject to Section 409A of the Code, the amount of any such expenses eligible for reimbursement, or the provision of any in-kind benefit, in one calendar year shall not affect the expenses eligible for reimbursement in any other taxable year (except for any lifetime or other aggregate limitation applicable to medical expenses), in no event shall any expenses be reimbursed after the last day of the calendar year following the calendar year in which the Employee incurred such expenses, and in no event shall any right to reimbursement or the provision of any in-kind benefit be subject to liquidation or exchange for another benefit.

13. Assignment. This Agreement will be binding upon and inure to the benefit of (a) the heirs, executors and legal representatives of Employee upon Employee's death and (b) any successor of the Company. Any such successor of the Company will be deemed substituted for the Company under the terms of this Agreement for all purposes. For this purpose, "successor" means any person, firm, corporation or other business entity which at any time, whether by purchase, merger or otherwise, directly or indirectly acquires all or substantially all of the assets or business of the Company. None of the rights of Employee to receive any form of compensation payable pursuant to this Agreement may be assigned or transferred except by will or the laws of descent and distribution. Any other attempted assignment, transfer, conveyance or other disposition of Employee's right to compensation or other benefits will be null and void.

14. Notices. All notices, requests, demands and other communications called for hereunder shall be in writing and shall be deemed given (i) on the date of delivery if delivered personally, (ii) one (1) day after being sent by a well established commercial overnight service, or (iii) four (4) days after being mailed by registered or certified mail, return receipt requested, prepaid and addressed to the parties or their successors at the following addresses, or at such other addresses as the parties may later designate in writing:

If to the Company:

Natus Medical, Inc.
1501 Industrial Road
San Carlos, CA 94070
Attn: James Hawkins Chief Executive Officer

If to Employee:

at the last residential address known by the Company.

15. Severability. In the event that any provision hereof becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement will continue in full force and effect without said provision.

16. Arbitration.

(a) General. In consideration of Employee's service to the Company, its promise to arbitrate all employment related disputes and Employee's receipt of the compensation, pay raises and other benefits paid to Employee by the Company, at present and in the future, Employee agrees that any and all controversies, claims, or disputes with anyone (including the Company and any employee, officer, director, shareholder or benefit plan of the Company in their capacity as such or otherwise) arising out of, relating to, or resulting from Employee's service to the Company under this Agreement or otherwise or the termination of Employee's service with the Company, including any breach of this Agreement, shall be subject to binding arbitration under the Arbitration Rules set forth in California Code of Civil Procedure Section 1280 through 1294.2, including Section 1283.05 (the "Rules") and pursuant to California law. Disputes which Employee agrees to arbitrate, and thereby agrees to waive any right to a trial by jury, include any statutory claims under state or federal law, including, but not limited to, claims under Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act of 1990, the Age Discrimination in Employment Act of 1967, the Older Workers Benefit Protection Act, the California Fair Employment and Housing Act, the California Labor Code, claims of harassment, discrimination or wrongful termination and any statutory claims. Employee further understands that this Agreement to arbitrate also applies to any disputes that the Company may have with Employee.

(b) Procedure. Employee agrees that any arbitration will be administered by the American Arbitration Association (“AAA”) and that a neutral arbitrator will be selected in a manner consistent with its National Rules for the Resolution of Employment Disputes. The arbitration proceedings will allow for discovery according to the rules set forth in the *National Rules for the Resolution of Employment Disputes* or *California Code of Civil Procedure*. Employee agrees that the arbitrator shall have the power to decide any motions brought by any party to the arbitration, including motions for summary judgment and/or adjudication and motions to dismiss and demurrers, prior to any arbitration hearing. Employee agrees that the arbitrator shall issue a written decision on the merits. Employee also agrees that the arbitrator shall have the power to award any remedies, including attorneys’ fees and costs, available under applicable law. Employee understands the Company will pay for any administrative or hearing fees charged by the arbitrator or AAA except that Employee shall pay the first \$200.00 of any filing fees associated with any arbitration Employee initiates. Employee agrees that the arbitrator shall administer and conduct any arbitration in a manner consistent with the Rules and that to the extent that the AAA’s National Rules for the Resolution of Employment Disputes conflict with the Rules, the Rules shall take precedence.

(c) Remedy. Except as provided by the Rules, arbitration shall be the sole, exclusive and final remedy for any dispute between Employee and the Company. Accordingly, except as provided for by the Rules, neither Employee nor the Company will be permitted to pursue court action regarding claims that are subject to arbitration. Notwithstanding, the arbitrator will not have the authority to disregard or refuse to enforce any lawful Company policy, and the arbitrator shall not order or require the Company to adopt a policy not otherwise required by law that the Company has not adopted.

(d) Availability of Injunctive Relief. In addition to the right under the Rules to petition the court for provisional relief, Employee agrees that any party may also petition the court for injunctive relief where either party alleges or claims a violation of this Agreement or the Confidentiality Agreement or any other agreement regarding trade secrets, confidential information, nonsolicitation or Labor Code §2870. In the event either party seeks injunctive relief, the prevailing party shall be entitled to recover reasonable costs and attorneys’ fees.

(e) Administrative Relief. Employee understands that this Agreement does not prohibit Employee from pursuing an administrative claim with a local, state or federal administrative body such as the Department of Fair Employment and Housing, the Equal Employment Opportunity Commission or the workers’ compensation board. This Agreement does, however, preclude Employee from pursuing court action regarding any such claim.

(f) Voluntary Nature of Agreement. Employee acknowledges and agrees that Employee is executing this Agreement voluntarily and without any duress or undue influence by the Company or anyone else. Employee further acknowledges and agrees that Employee has carefully read this Agreement and that Employee has asked any questions needed for Employee to understand the terms, consequences and binding effect of this Agreement and fully understand it, including that Employee is waiving Employee’s right to a jury trial. Finally, Employee agrees that Employee has been provided an opportunity to seek the advice of an attorney of Employee’s choice before signing this Agreement.

17. Integration. This Agreement, together with the any Company stock awards plan pursuant to which stock options, restricted stock, restricted stock units or other equity awards have been made to Employee, any agreements representing any such equity awards, and the Confidential Information Agreement represents the entire agreement and understanding between the parties as to the subject matter herein and supersedes all prior or contemporaneous agreements whether written or oral. No waiver, alteration, or modification of any of the provisions of this Agreement will be binding unless it is in writing and specifically mentions this Section 16 and it is signed by duly authorized representatives of the parties hereto.

18. Waiver of Breach. The waiver of a breach of any term or provision of this Agreement, which must be in writing, shall not operate as or be construed to be a waiver of any other previous or subsequent breach of this Agreement.

19. Headings. All captions and section headings used in this Agreement are for convenient reference only and do not form a part of this Agreement.

20. Tax Withholding. All payments made pursuant to this Agreement will be subject to withholding of applicable taxes.

21. Governing Law. This Agreement will be governed by the laws of the State of California (with the exception of its conflict of laws provisions).

22. Acknowledgment. Employee acknowledges that he has had the opportunity to discuss this matter with and obtain advice from his private attorney, has had sufficient time to, and has carefully read and fully understands all the provisions of this Agreement, and is knowingly and voluntarily entering into this Agreement.

23. Counterparts. This Agreement may be executed in counterparts, and each counterpart shall have the same force and effect as an original and shall constitute an effective, binding agreement on the part of each of the undersigned.

[Signature Page to Follow]

IN WITNESS WHEREOF, each of the parties has executed this Agreement, in the case of the Company by their duly authorized officers, as of the day and year first above written.

COMPANY:

NATUS MEDICAL INCORPORATED

By: /s/ Jim Hawkins
Jim Hawkins

Date: _____

Title: Chief Executive Officer

EMPLOYEE:

/s/ Jonathan A. Kennedy
Jonathan A. Kennedy

Date: _____

[Signature Page to Employment Agreement]

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James B. Hawkins, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Natus Medical Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2013

/s/ James B. Hawkins

James B. Hawkins

Chief Executive Officer

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jonathan Kennedy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Natus Medical Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2013

/s/ Jonathan A. Kennedy

Jonathan A. Kennedy
Senior Vice President Finance
and Chief Financial Officer

CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO TITLE 18, UNITED STATES CODE, SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Natus Medical Incorporated (the "Company") on Form 10-Q for the quarter ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James B. Hawkins, Chief Executive Officer of the Company, certify, pursuant to Title 18, United States Code, Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James B. Hawkins

Print Name: James B. Hawkins

Title: Chief Executive Officer

Date: August 8, 2013

In connection with the Quarterly Report of Natus Medical Incorporated (the "Company") on Form 10-Q for the quarter ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jonathan Kennedy, Senior Vice President Finance and Chief Financial Officer of the Company, certify, pursuant to Title 18, United States Code, Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jonathan A. Kennedy

Print Name: Jonathan A. Kennedy

Title: Senior Vice President Finance and Chief
Financial Officer

Date: August 8, 2013