
**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, 2016

- 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.)

6701 Koll Center Parkway, Suite 120, Pleasanton, CA 94566
(Address of principal executive offices) (Zip Code)

(925) 223-6700
(Registrant's telephone number, including area code)

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.:

| | | | |
|-------------------------|--|---------------------------|--------------------------|
| Large Accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

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 July 29, 2016 was 32,950,791.

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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)**

| | June 30, 2016 | December 31, 2015 |
|---|----------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 96,284 | \$ 82,469 |
| Accounts receivable, net of allowance for doubtful accounts of \$5,176 in 2016 and \$4,686 in 2015 | 93,102 | 99,080 |
| Inventories | 43,620 | 48,572 |
| Prepaid expenses and other current assets | 12,925 | 11,235 |
| Total current assets | <u>245,931</u> | <u>241,356</u> |
| Property and equipment, net | 17,174 | 16,967 |
| Intangible assets, net | 81,309 | 86,536 |
| Goodwill | 110,864 | 107,466 |
| Deferred income tax | 12,809 | 12,782 |
| Other assets | 18,005 | 14,389 |
| Total assets | <u>\$ 486,092</u> | <u>\$ 479,496</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 18,836 | \$ 23,660 |
| Short-term borrowings | 10,000 | — |
| Accrued liabilities | 37,306 | 42,137 |
| Deferred revenue | 11,262 | 11,311 |
| Total current liabilities | <u>77,404</u> | <u>77,108</u> |
| Long-term liabilities: | | |
| Other liabilities | 8,632 | 7,781 |
| Deferred income tax | 3,839 | 3,897 |
| Total liabilities | <u>89,875</u> | <u>88,786</u> |
| Stockholders' equity: | | |
| Common Stock, \$0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 32,942,199 in 2016 and 33,153,500 in 2015 | 311,626 | 323,745 |
| Preferred stock, \$0.001 par value; 10,000,000 shares authorized; no shares issued and outstanding in 2016 and 2015 | — | — |
| Retained earnings | 125,865 | 106,814 |
| Accumulated other comprehensive loss | (41,274) | (39,849) |
| Total stockholders' equity | <u>396,217</u> | <u>390,710</u> |
| Total liabilities and stockholders' equity | <u>\$ 486,092</u> | <u>\$ 479,496</u> |

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(unaudited)
(in thousands, except per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | \$ 95,958 | \$ 91,937 | \$ 183,287 | \$ 181,332 |
| Cost of revenue | 37,879 | 33,844 | 70,348 | 68,948 |
| Intangibles amortization | 604 | 683 | 1,205 | 1,366 |
| Gross profit | 57,475 | 57,410 | 111,734 | 111,018 |
| Operating expenses: | | | | |
| Marketing and selling | 21,237 | 22,108 | 41,831 | 42,850 |
| Research and development | 7,105 | 7,309 | 14,907 | 14,167 |
| General and administrative | 11,923 | 11,656 | 24,404 | 23,208 |
| Intangibles amortization | 2,197 | 2,174 | 4,332 | 3,129 |
| Restructuring | 1,083 | 161 | 1,118 | 316 |
| Total operating expenses | 43,545 | 43,408 | 86,592 | 83,670 |
| Income from operations | 13,930 | 14,002 | 25,142 | 27,348 |
| Other income (expense), net | 25 | (380) | 481 | (1,210) |
| Income before provision for income tax | 13,955 | 13,622 | 25,623 | 26,138 |
| Provision for income tax expense | 3,443 | 3,771 | 6,573 | 7,691 |
| Net income | \$ 10,512 | \$ 9,851 | \$ 19,050 | \$ 18,447 |
| Foreign currency translation adjustment | (2,085) | 1,269 | (1,425) | (3,810) |
| Comprehensive income | \$ 8,427 | \$ 11,120 | \$ 17,625 | \$ 14,637 |
| Earnings per share: | | | | |
| Basic | \$ 0.32 | \$ 0.31 | \$ 0.59 | \$ 0.57 |
| Diluted | \$ 0.32 | \$ 0.30 | \$ 0.58 | \$ 0.56 |
| Weighted average shares used in the calculation of earnings per share: | | | | |
| Basic | 32,438 | 32,273 | 32,521 | 32,201 |
| Diluted | 32,983 | 33,204 | 33,118 | 33,158 |

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|------------------|
| | 2016 | 2015 |
| Operating activities: | | |
| Net income | \$ 19,050 | \$ 18,447 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for losses on accounts receivable | 760 | 583 |
| Excess tax benefit on the exercise of stock options | — | (4,371) |
| Depreciation and amortization | 8,396 | 7,178 |
| Loss on disposal of property and equipment | (31) | — |
| Warranty reserve | 2,312 | 3,153 |
| Share-based compensation | 5,003 | 3,491 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 7,594 | (967) |
| Inventories | 352 | (4,880) |
| Prepaid expenses and other assets | (1,793) | 2,283 |
| Accounts payable | (4,686) | (1,866) |
| Accrued liabilities | (4,024) | (7,002) |
| Deferred revenue | 123 | (1,219) |
| Deferred income tax | (63) | 4,693 |
| Net cash provided by operating activities | <u>32,993</u> | <u>19,523</u> |
| Investing activities: | | |
| Acquisition of businesses, net of cash acquired | (6,150) | (11,559) |
| Purchases of property and equipment | (2,103) | (2,375) |
| Purchase of intangible assets | (241) | (890) |
| Net cash used in investing activities | <u>(8,494)</u> | <u>(14,824)</u> |
| Financing activities: | | |
| Proceeds from stock option exercises and Employee Stock Purchase Program purchases | 2,207 | 5,715 |
| Excess tax benefit on the exercise of stock options | — | 4,371 |
| Repurchase of common stock | (16,754) | (5,515) |
| Taxes paid related to net share settlement of equity awards | (2,575) | (1,649) |
| Contingent consideration earn-out | (1,284) | (664) |
| Proceeds from short-term borrowings | 16,000 | — |
| Payments on borrowings | (6,000) | — |
| Net cash used in financing activities | <u>(8,406)</u> | <u>2,258</u> |
| Exchange rate changes effect on cash and cash equivalents | <u>(2,278)</u> | <u>(277)</u> |
| Net increase in cash and cash equivalents | 13,815 | 6,680 |
| Cash and cash equivalents, beginning of period | 82,469 | 66,558 |
| Cash and cash equivalents, end of period | <u>\$ 96,284</u> | <u>\$ 73,238</u> |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 10 | \$ — |
| Cash paid for income taxes | <u>\$ 7,755</u> | <u>\$ 2,491</u> |
| Non-cash investing activities: | | |
| Property and equipment included in accounts payable | \$ 64 | \$ 209 |
| Inventory transferred to property and equipment | <u>\$ 362</u> | <u>\$ 593</u> |

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”). 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, 2015.

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, and 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 consolidated balance sheet as of December 31, 2015 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, 2015. We have made certain reclassifications to the prior period to conform to current period presentation.

Operating results for the six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 sets forth a new revenue recognition model that requires identifying the contract, identifying the performance obligations, determining the transaction price, allocating the transaction price to performance obligations and recognizing the revenue upon satisfaction of performance obligations.

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

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This standard requires a lessee to recognize the lease assets and lease liabilities arising from operating leases in the statement of financial position. Qualitative along with specific quantitative disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 including interim periods within those fiscal years.

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting*. The new standard contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and

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classification on the statement of cash flows. The changes in the new standard eliminate the accounting for excess tax benefits to be recognized in additional paid-in capital and tax deficiencies recognized either in the income tax provision or in additional paid-in capital. The Company elected early adoption of ASU 2016-09 in the first quarter of 2016 which was applied using a modified retrospective approach. For the six months ended June 30, 2016, we recognized all excess tax benefits and tax deficiencies as income tax expense or benefit as a discrete event. An income tax benefit of approximately \$1.4 million was recognized in the period ended June 30, 2016 as a result of the adoption of ASU 2016-09. There was no change to retained earnings with respect to excess tax benefits, as this is not applicable to the Company. The treatment of forfeitures has not changed as we are electing to continue our current process of estimating the number of forfeitures. As such, this has no cumulative effect on retained earnings. With the early adoption of 2016-09, we have elected to present the cash flow statement on a prospective transition method and no prior periods have been adjusted.

2 - Business Combinations

RetCam

On July 6, 2016, we acquired the portfolio of RetCam imaging systems from Clarity Medical Systems, Inc. for \$10.6 million in cash. RetCam is an imaging system used to diagnose and monitor a range of ophthalmic maladies in premature infants. The purchase agreement also included an asset consideration holdback of \$2.0 million. Results of operations for RetCam will be included in our consolidated financial statements from the date of acquisition.

NeuroQuest

On March 2, 2016, we acquired NeuroQuest, LLC ("NeuroQuest") through an asset purchase. NeuroQuest complements our Global Neuro-Diagnostics ("GND") and Monarch Medical Diagnostics, LLC ("Monarch") acquisitions which offer patients a convenient way to complete routine-electroencephalography ("EEG") and extended video electronencephalography ("VEEG") testing. The cash consideration for NeuroQuest was \$4.6 million. The purchase agreement also included an asset consideration holdback of \$0.5 million. Purchase price allocation is considered preliminary at this time and expected to be finalized during the third quarter of 2016. Pro forma financial information for the NeuroQuest acquisition is not presented as it is not considered material.

Monarch

We acquired Monarch through an asset purchase on November 13, 2015. Monarch's service complements our GND acquisition which offers patients a convenient way to complete routine and extended video EEG diagnostic testing. The service also provides comprehensive reporting and support to the physician. The cash consideration for Monarch was \$2.7 million. The purchase agreement also included a contingent consideration holdback of \$1.0 million which we paid on January 11, 2016. Pro forma financial information for the Monarch acquisition is not presented as it is not considered material.

Global Neuro-Diagnostics

We acquired GND through an equity purchase on January 23, 2015. GND's service offers patients a convenient way to complete routine and extended video EEG diagnostic testing, which can be performed at the home, hospital or physician's office. The service also provides comprehensive reporting and support to the physician. The cash consideration for GND was \$11.4 million. The purchase agreement also included an earn-out condition which we estimate to be \$3.3 million. This earn-out is contingent upon GND achieving certain revenue milestones from 2015 to 2017. Pro forma financial information for the GND acquisition is not presented as it is not considered material.

NicView

On January 2, 2015, we purchased the assets of NicView for cash consideration of \$1.1 million. NicView provides streaming video for families with babies in the neonatal intensive care unit. The asset purchase agreement included an earn-out condition of \$1.3 million that was contingent upon orders received and installed by February 28, 2016. The earn-out was paid on March 28, 2016. Pro forma financial information for the NicView acquisition is not presented as it is not considered material.

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3 - Earnings Per Share

The components of basic and diluted EPS are as follows (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|----------|------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$ 10,512 | \$ 9,851 | \$ 19,050 | \$ 18,447 |
| Weighted average common shares | 32,438 | 32,273 | 32,521 | 32,201 |
| Dilutive effect of stock based awards | 545 | 931 | 597 | 957 |
| Diluted Shares | 32,983 | 33,204 | 33,118 | 33,158 |
| Basic earnings per share | \$ 0.32 | \$ 0.31 | \$ 0.59 | \$ 0.57 |
| Diluted earnings per share | \$ 0.32 | \$ 0.30 | \$ 0.58 | \$ 0.56 |
| Shares excluded from calculation of diluted EPS | 186 | — | 183 | — |

4 - Inventories

Inventories consist of the following (in thousands):

| | June 30, 2016 | December 31, 2015 |
|---------------------------------|---------------|-------------------|
| Raw materials and subassemblies | \$ 21,704 | \$ 19,041 |
| Work in process | 1,460 | 1,343 |
| Finished goods | 32,263 | 36,149 |
| Total inventories | 55,427 | 56,533 |
| Less: Non-current inventories | (11,807) | (7,961) |
| Inventories, current | \$ 43,620 | \$ 48,572 |

At June 30, 2016 and December 31, 2015, we have classified \$11.8 million and \$8.0 million, respectively, of inventories as other assets. We expect that we will not use this inventory within the next twelve months. This inventory consists primarily of last time buy items from our suppliers, service components used to repair products pursuant to warranty obligations and extended service contracts, including service components for products we are not currently selling and inventory that we purchased in bulk quantities. 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):

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| | June 30, 2016 | | | | December 31, 2015 | | | |
|--|-----------------------|------------------------|--------------------------|------------------|-----------------------|------------------------|--------------------------|------------------|
| | 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 | \$ 63,343 | \$ — | \$ (33,277) | \$ 30,066 | \$ 63,668 | \$ — | \$ (31,600) | \$ 32,068 |
| Customer related | 36,817 | — | (15,993) | 20,824 | 35,529 | — | (14,352) | 21,177 |
| Trade names | 31,869 | (3,369) | (5,089) | 23,411 | 31,837 | (3,340) | (3,052) | 25,445 |
| Internally developed software | 15,739 | — | (9,168) | 6,571 | 15,513 | — | (8,155) | 7,358 |
| Patents | 2,684 | — | (2,247) | 437 | 2,663 | — | (2,175) | 488 |
| Backlog | 718 | — | (718) | — | 717 | — | (717) | — |
| Definite-lived intangible assets | <u>\$ 151,170</u> | <u>\$ (3,369)</u> | <u>\$ (66,492)</u> | <u>\$ 81,309</u> | <u>\$ 149,927</u> | <u>\$ (3,340)</u> | <u>\$ (60,051)</u> | <u>\$ 86,536</u> |

Finite-lived intangible assets are amortized over their useful lives, which are 5 to 20 years for technology, 4 to 16 years for customer related intangibles, 4 to 10 years for internally developed software, 7 years for trade names, and 10 to 15 years for patents.

Internally developed software consists of \$13.5 million relating to costs incurred for development of internal use computer software and \$2.2 million 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, | |
|-------------------------------|--------------------------------|-----------------|------------------------------|-----------------|
| | 2016 | 2015 | 2016 | 2015 |
| Technology | \$ 855 | \$ 961 | \$ 1,708 | \$ 1,921 |
| Customer related | 853 | 715 | 1,646 | 1,404 |
| Trade names | 1,019 | 1,025 | 2,037 | 1,025 |
| Internally developed software | 528 | 353 | 1,017 | 707 |
| Patents | 28 | 28 | 56 | 56 |
| Total amortization | <u>\$ 3,283</u> | <u>\$ 3,082</u> | <u>\$ 6,464</u> | <u>\$ 5,113</u> |

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

| | |
|-------------------------------------|------------------|
| Six months ending December 31, 2016 | \$ 6,381 |
| 2017 | 12,557 |
| 2018 | 12,333 |
| 2019 | 11,174 |
| 2020 | 8,975 |
| 2021 | 8,014 |
| Thereafter | 21,875 |
| Total expected amortization expense | <u>\$ 81,309</u> |

6 – Goodwill

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

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| | | |
|------------------------------|----|----------------|
| December 31, 2015 | \$ | 107,466 |
| Acquisitions | | 3,500 |
| Foreign currency translation | | (102) |
| June 30, 2016 | \$ | <u>110,864</u> |

7 - Property and Equipment, net

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

| | <u>June 30, 2016</u> | <u>December 31, 2015</u> |
|------------------------------------|----------------------|--------------------------|
| Land | \$ 2,866 | \$ 2,918 |
| Buildings | 5,344 | 5,662 |
| Leasehold improvements | 2,392 | 2,345 |
| Office furniture and equipment | 14,040 | 13,866 |
| Computer software and hardware | 12,189 | 10,488 |
| Demonstration and loaned equipment | 11,574 | 11,216 |
| | <u>48,405</u> | <u>46,495</u> |
| Accumulated depreciation | (31,231) | (29,528) |
| Total | \$ <u>17,174</u> | \$ <u>16,967</u> |

Depreciation expense of property and equipment was approximately \$0.9 million and \$1.9 million for the three and six months ended June 30, 2016, respectively, and approximately \$1.0 million and \$2.1 million for the three and six months ended June 30, 2015, respectively.

8 - Reserve for Product Warranties

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

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

As of June 30, 2016 we had accrued \$6.6 million of estimated costs to bring certain NeoBLUE® phototherapy products into U.S. regulatory compliance. Our estimate of these costs is primarily based upon the number of units outstanding that may require repair and costs associated with shipping and repairing the product. We expect that costs associated with bringing the products back into compliance will not be incurred until the third quarter of 2016. Additional costs could be incurred in future periods to bring products into regulatory compliance, but such costs cannot currently be reasonably estimated.

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

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------|--------------------------------|----------|------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Balance, beginning of period | \$ 10,577 | \$ 2,975 | \$ 10,386 | \$ 2,753 |
| Additions charged to expense | 1,383 | 2,278 | 2,312 | 3,153 |
| Reductions | (1,102) | (845) | (1,840) | (1,498) |
| Balance, end of period | \$ 10,858 | \$ 4,408 | \$ 10,858 | \$ 4,408 |

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

As of June 30, 2016, we have two active share-based compensation plans, the 2011 Stock Awards Plan and the 2011 Employee Stock Purchase Plan. The terms of awards granted during the six months ended June 30, 2016 and our methods for determining grant-date fair value of the awards are consistent with those described in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Details of share-based compensation expense are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|----------|------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of revenue | \$ 43 | \$ 36 | \$ 119 | \$ 87 |
| Marketing and selling | 174 | 322 | 453 | 685 |
| Research and development | 352 | 178 | 865 | 395 |
| General and administrative | 1,533 | 1,224 | 3,566 | 2,324 |
| Total | \$ 2,102 | \$ 1,760 | \$ 5,003 | \$ 3,491 |

As of June 30, 2016, unrecognized compensation expense related to the unvested portion of our stock options and other stock awards was approximately \$13.6 million, which is expected to be recognized over a weighted average period of 1.9 years.

10 - Other Income (Expense), net

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|--------------------------------|----------|------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Interest income | \$ 10 | \$ 6 | \$ 18 | \$ 16 |
| Interest expense | (97) | — | (129) | — |
| Foreign currency gain (loss) | 52 | (501) | 502 | (1,491) |
| Other | 60 | 115 | 90 | 265 |
| Total other income (expense), net | \$ 25 | \$ (380) | \$ 481 | \$ (1,210) |

11 - Income Taxes

Provision for Income Tax Expense

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We recorded provisions for income tax of \$3.4 million and \$6.6 million for the three and six months ended June 30, 2016, respectively. Our effective tax rate was 24.7% and 25.7% for the three and six months ended June 30, 2016, respectively. We recorded provisions for income tax of \$3.8 million and \$7.7 million for the three and six months ended June 30, 2015, respectively. Our effective tax rate was 27.7% and 29.4% for the three and six months ended June 30, 2015, respectively.

Our effective tax rate for the three and six months ended June 30, 2016 differed from the federal statutory tax rate primarily because of profits in foreign jurisdictions with lower tax rates than the federal statutory rate. The decrease in the effective tax rate from the three and six months ended June 30, 2015 is primarily attributable to shifts in the geographical mix of income.

Our year-to-date results reflect the projected fiscal year 2016 effective tax rate as adjusted for the impact of any quarterly discrete events. Discrete items for the three months ended June 30, 2016 include the tax rate impact from adoption of ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting and recording certain tax true-ups. The impact from the adoption of ASU 2016-09 decreased our quarterly effective tax rate by 4.4%. Independent from the adoption of ASU 2016-09, the foreign tax true-up we recorded in this quarter increased our quarterly tax rate by 3.1%. Discrete items recorded during the three months ended June 30, 2015 increased the quarterly tax rate by 6.9%. The decrease in our quarterly effective tax rate, excluding the impact of discrete items for the three months ended June 30, 2016, compared with the three months ended June 30, 2015 is primarily attributable to forecasted shifts in the geographical mix of income.

We recorded \$0.6 million net tax expense unrecognized tax benefits for the six months ended June 30, 2016. Within the next twelve months, it is possible our uncertain tax benefit may change within a range of approximately zero to \$0.5 million. Our tax returns remain open to examinations as follows: U.S. Federal, 2012 through 2015, U.S. States 2011 through 2015 and significant foreign jurisdictions 2012 through 2015.

12 - Restructuring Reserves

Historically, the Company has completed multiple acquisitions of other companies and businesses. Following an acquisition the Company will, as it determines appropriate, initiate restructuring events to eliminate redundant costs to maintain a competitive cost structure. Restructuring expenses are related to permanent reductions in workforce and redundant facility closures.

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

Activity in the restructuring reserves for the six months ended June 30, 2016 is as follows (in thousands):

| | Personnel Related | Facility Related | Total |
|------------------------------|--------------------------|-------------------------|--------------|
| Balance at December 31, 2015 | \$ 1,676 | \$ — | \$ 1,676 |
| Additions | 255 | 1,274 | 1,529 |
| Reversals | (425) | — | (425) |
| Payments | (995) | (388) | (1,383) |
| Balance at June 30, 2016 | \$ 511 | \$ 886 | \$ 1,397 |

13 - Debt and Credit Arrangements

The Company has a Credit Agreement with Citibank, National Association ("Citibank"). Pursuant to the Credit Agreement, Citibank agrees, on a non-committed basis, to make loans to us from time to time, not to exceed at any time the aggregate principal amount of \$25.0 million. The proceeds under the Revolving Line of Credit may be used by us for working capital and general corporate purposes. The Credit Agreement contains covenants, including covenants relating to maintenance of books and records, financial reporting and notification, compliance with laws, maintenance of properties and insurance, and limitations on guaranties, investments, issuance of debt,

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lease obligations and capital expenditures. The Credit Agreement provides for events of default, including failure to pay any principal or interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have no other significant credit facilities.

Short-term borrowings at June 30, 2016 consists of \$10.0 million under the credit facility in the form of revolving debt, with an interest rate of LIBOR plus 1.75%.

At June 30, 2016, the carrying value of total debt approximates fair market value. The fair value of the Company's debt is considered a Level 3 measurement.

14 - Segment, Customer and Geographic Information

We operate in one reportable segment in which we provide healthcare products and services 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 are as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|--------------------------------|-----------|------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Consolidated Revenue: | | | | |
| United States | \$ 67,528 | \$ 60,505 | \$ 124,425 | \$ 115,069 |
| Foreign countries | 28,430 | 31,432 | 58,862 | 66,263 |
| Totals | \$ 95,958 | \$ 91,937 | \$ 183,287 | \$ 181,332 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|-----------|------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue by End Market: | | | | |
| Neurology Products | | | | |
| Devices and Systems | \$ 42,931 | \$ 40,985 | \$ 82,128 | \$ 81,094 |
| Supplies | 15,067 | 15,441 | 30,101 | 30,317 |
| Services | 3,222 | 2,201 | 5,663 | 3,489 |
| Total Neurology Revenue | 61,220 | 58,627 | 117,892 | 114,900 |
| Newborn Care Products | | | | |
| Devices and Systems | 16,967 | 17,744 | 30,508 | 36,108 |
| Supplies | 12,272 | 12,262 | 23,886 | 24,650 |
| Services | 5,499 | 3,304 | 11,001 | 5,674 |
| Total Newborn Care Revenue | 34,738 | 33,310 | 65,395 | 66,432 |
| Total Revenue | \$ 95,958 | \$ 91,937 | \$ 183,287 | \$ 181,332 |

| | June 30, 2016 | December 31, 2015 |
|-------------------------|------------------------------|-------------------|
| | Property and equipment, net: | |
| United States | \$ 6,855 | \$ 6,664 |
| Canada | 5,042 | 5,165 |
| Argentina | 2,033 | 2,361 |
| Ireland | 1,883 | 1,651 |
| Other foreign countries | 1,361 | 1,126 |
| Totals | \$ 17,174 | \$ 16,967 |

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During the three and six months ended June 30, 2016 and 2015, 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.

The Company does not have any financial assets or liabilities measured at fair value on a recurring basis.

The following financial instruments are not measured at fair value on the Company's consolidated balance sheet as of June 30, 2016 and December 31, 2015, but require disclosure of their fair values: cash and cash equivalents, accounts receivable, and accounts payable. The carrying value of these financial instruments approximates fair values because of their relatively short maturity.

In the third quarter of 2014, the Company listed its facility in Mundelein, Illinois for sale. This asset was measured at fair value less cost to sell as of September 30, 2014 based on market price and is classified as a Level 2 asset. The book value of this asset on June 30, 2014 was \$3.6 million. We expensed \$2.2 million during the third quarter of 2014 for this impairment. As of June 30, 2016 we are carrying the asset as held for sale in other current assets on the accompanying condensed consolidated balance sheet at a value of \$1.4 million.

The Company also has contingent consideration associated with earn-outs from acquisitions. Contingent consideration liabilities are classified as Level 3 liabilities, as the Company uses unobservable inputs to value them, which is a probability-based income approach. Contingent considerations are classified as accrued liabilities on our condensed consolidated balance sheet. Subsequent changes in the fair value of contingent consideration liabilities are recorded within the Company's income statement as an operating expense.

| | <u>December 31, 2015</u> | <u>Additions</u> | <u>Payments</u> | <u>Adjustments</u> | <u>June 30, 2016</u> |
|--------------------------|--------------------------|------------------|-----------------|--------------------|----------------------|
| Liabilities: | | | | | |
| Contingent consideration | \$ 6,209 | \$ 500 | \$ (2,284) | \$ (611) | \$ 3,814 |
| Total | \$ 6,209 | \$ 500 | \$ (2,284) | \$ (611) | \$ 3,814 |

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

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

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, 2015 of Natus Medical Incorporated. MD&A should be read in conjunction with our condensed consolidated financial

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statements and accompanying footnotes, the risk factors referred to in Part II, Item 1A of this report, our Annual Report filed on Form 10-K for the year ended December 31, 2015 and the cautionary information regarding forward-looking statements at the end of this section.

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.

We have completed a number of acquisitions since 2003, consisting of either the purchase of a company, substantially all of the assets of a company, or individual products or product lines. In 2015 and in the first quarter of 2016, we completed four acquisitions, NicView, GND, Monarch, and NeuroQuest. We expect to continue to pursue opportunities to acquire other businesses in the future.

End Markets

Our products address two primary end markets:

- **Neurology** - Includes products and services for diagnostic electroencephalography and long term monitoring, Intensive Care Unit monitoring, electromyography, sleep analysis or polysomnography, intra-operative monitoring, and diagnostic and monitoring transcranial doppler ultrasound technology.
- **Newborn Care** - Includes products and services for newborn care including video streaming, hearing screening, brain injury, thermoregulation, jaundice management, retinopathy of prematurity, and various disposable products, as well as products for diagnostic hearing assessment for children through adult populations, and products to diagnose and assist in treating balance and mobility disorders.

Segment and Geographic Information

We operate in one reportable segment, which we have presented as the aggregation of our neurology and newborn care product families. Within this reportable segment we are organized on the basis of the healthcare products and services we provide which are used for the screening, detection, treatment, monitoring, and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, and sleep disorders.

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

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

Revenue by Product Category

We generate our revenue 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, 2015. Revenue from Devices and Systems, Supplies, and Services, as a percent of total revenue for the three and six months ended June 30, 2016 and 2015, is as follows:

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------|--------------------------------|------|------------------------------|------|
| | 2016 | 2015 | 2016 | 2015 |
| Devices and Systems | 62% | 64% | 61% | 65% |
| Supplies | 28% | 30% | 29% | 30% |
| Services | 9% | 6% | 9% | 5% |
| Total | 100% | 100% | 100% | 100% |

During the three and six months ended June 30, 2016 and 2015, no single customer or foreign country contributed to more than 10% of revenue.

2016 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 outside the United States.

Our consolidated revenue increased \$4.0 million in the second quarter ended June 30, 2016 to \$96.0 million compared to \$91.9 million in the second quarter of the previous year. Our revenue increases were primarily in the domestic markets for Neurology and Newborn Care device sales and our service businesses, partially offset by declines in international market device sales.

Net income was \$10.5 million or \$0.32 per diluted share in the three months ended June 30, 2016, compared with net income of \$9.9 million or \$0.30 per diluted share in the same period in 2015. The increase in net income was a result of higher revenue, partially offset by a decrease in gross profit due to product mix and higher warranty and restructuring costs for the current quarter.

Application of Critical Accounting Policies

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

We believe that the following critical accounting policies require the use of significant estimates, assumptions, and judgments:

- Revenue recognition
- Inventory carried at the lower of cost or market value
- Carrying value of intangible assets and goodwill
- Liability for product warranties
- Share-based compensation

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. These critical accounting policies are described in more detail in our Annual Report on Form 10-K for the year ended December 31, 2015, under Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

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Results of Operations

The following table sets forth selected consolidated statement of operations data as a percentage of total revenue for the periods indicated:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | 100.0% | 100.0 % | 100.0% | 100.0 % |
| Cost of revenue | 39.5% | 36.8 % | 38.4% | 38.0 % |
| Intangibles amortization | 0.6% | 0.7 % | 0.7% | 0.8 % |
| Gross profit | 59.9% | 62.5 % | 60.9% | 61.2 % |
| Operating expenses: | | | | |
| Marketing and selling | 22.1% | 24.0 % | 22.8% | 23.6 % |
| Research and development | 7.4% | 8.0 % | 8.1% | 7.8 % |
| General and administrative | 12.4% | 12.7 % | 13.3% | 12.8 % |
| Intangibles Amortization | 2.3% | 2.4 % | 2.4% | 1.7 % |
| Restructuring | 1.1% | 0.2 % | 0.6% | 0.2 % |
| Total operating expenses | 45.3% | 47.3 % | 47.2% | 46.1 % |
| Income from operations | 14.6% | 15.2 % | 13.7% | 15.1 % |
| Other expense, net | —% | (0.4)% | 0.3% | (0.7)% |
| Income before provision for income tax | 14.6% | 14.8 % | 14.0% | 14.4 % |
| Provision for income tax expense | 3.6% | 4.1 % | 3.6% | 4.2 % |
| Net income | 11.0% | 10.7 % | 10.4% | 10.2 % |

Revenues

The following table shows revenue by products during the three and six months ended June 30, 2016 and June 30, 2015 (in thousands):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|----------------------------|--------------------------------|-----------|--------|------------------------------|------------|--------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Neurology Products | | | | | | |
| Devices and Systems | \$ 42,931 | \$ 40,985 | 5 % | \$ 82,128 | \$ 81,094 | 1 % |
| Supplies | 15,067 | 15,441 | (2)% | 30,101 | 30,317 | (1)% |
| Services | 3,222 | 2,201 | 46 % | 5,663 | 3,489 | 62 % |
| Total Neurology Revenue | 61,220 | 58,627 | 4 % | 117,892 | 114,900 | 3 % |
| Newborn Care Products | | | | | | |
| Devices and Systems | 16,967 | 17,744 | (4)% | 30,508 | 36,108 | (16)% |
| Supplies | 12,272 | 12,262 | — % | 23,886 | 24,650 | (3)% |
| Services | 5,499 | 3,304 | 66 % | 11,001 | 5,674 | 94 % |
| Total Newborn Care Revenue | 34,738 | 33,310 | 4 % | 65,395 | 66,432 | (2)% |
| Total Revenue | \$ 95,958 | \$ 91,937 | 4 % | \$ 183,287 | \$ 181,332 | 1 % |

For the three months ended June 30, 2016, Neurology revenue increased by 4% compared to the same quarter last year. Strong growth in our domestic market was partially offset by a decline in revenue from international markets, due mainly to ongoing weakness of European markets. Revenues from sales of Neurology Devices and Systems increased by 5%, driven mainly by growth in domestic EEG, PSG, and EMG, revenue partially offset by

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declines in international device revenue, particularly for PSG. Revenue from Supplies decreased by 2%, mainly due to decreased revenue in our domestic market. The growth in Services revenue is primarily the result of our January 2015 acquisition of Global Neuro-Diagnostics, our November 2015 acquisition of Monarch Diagnostics and our March 2016 acquisition of NeuroQuest.

For the three months ended June 30, 2016, Newborn Care revenue increased by 4% compared to the same quarter last year. Geographically, the increase was in our domestic markets. Revenue from Newborn Care Devices and Systems decreased by 4% compared to the same period last year. The decrease was primarily in the hearing and distributed products, offset by increases in phototherapy and video streaming products. We believe this decrease is due in part to customer delays in submitting orders in the international markets and some cannibalization of hearing products due to the growth of Peloton, our hearing screening service. The decrease in Newborn Care Devices and Systems was partially offset by revenue resulting from the release of a shipping hold on two of our phototherapy products and growth in sales of our video streaming product market, NicView. Revenue from Supplies was flat compared to the same period last year. Revenue from Services increased 66% compared to the same period last year. This increase was due to the growth of Peloton and the growth of our Data Management services.

For the six months ended June 30, 2016, Neurology revenue increased by 3% compared to the same period last year. Growth in our domestic market was partially offset by a decline in revenue from international markets, due mainly to ongoing weakness of European and Canadian markets. Revenues from sales of Neurology Devices and Systems increased by 1%, driven mainly by growth in domestic EEG and PSG revenue, partially offset by declines in international revenue. Revenue from Supplies decreased by 1%, mainly due to decreased revenue in our domestic market. The growth in Services revenue is the result of our acquisitions of Global Neuro-Diagnostics, Monarch Diagnostics, and NeuroQuest.

For the six months ended June 30, 2016, Newborn Care revenue increased by 1% compared to the same period last year. Geographically, the increase was in our domestic markets. Revenue from Devices and Systems decreased by 16% compared to the same period last year. The decrease was experienced across virtually all devices including hearing, incubators, and warmers, distributed products and brain injury, although we experienced an increase in revenue from phototherapy products due to the release of a shipping hold on two of our phototherapy products and in video streaming products. We believe the decrease in Newborn Care Devices and Systems is due in part to customer delays in submitting orders in both domestic and international markets, some cannibalization due to the growth of Peloton. Revenue from supplies decreased by 3% in the first half of 2016 as compared to the same period last year. Revenue from Services increased 94% compared to the same period last year. This increase was due to the growth of Peloton and the growth of our Data Management services.

No single customer or foreign country accounted for more than 10% of our revenue in the six months ended June 30, 2016 or June 30, 2015. Revenue from domestic sales increased 12% to \$67.5 million for the three months ended June 30, 2016 from \$60.5 million in the second quarter of 2015. Revenue from international sales decreased 10% to \$28.4 million for the three months ended June 30, 2016 compared to \$31.4 million in the second quarter of 2015. We believe the decrease in international revenue was driven by slowing international economies.

Cost of Revenue and Gross Profit

Cost of revenue and gross profit consists of (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------|--------------------------------|-----------|------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | \$ 95,958 | \$ 91,937 | \$ 183,287 | \$ 181,332 |
| Cost of revenue | 37,879 | 33,844 | 70,348 | 68,948 |
| Intangibles amortization | 604 | 683 | 1,205 | 1,366 |
| Gross profit | 57,475 | 57,410 | 111,734 | 111,018 |
| Gross profit percentage | 59.9% | 62.5% | 61.0% | 61.2% |

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For the three and six months ended June 30, 2016, gross profit as a percentage of revenue decreased 2.6% and 0.2%, respectively, compared to the same period in the prior year. This decrease in gross profit as a percentage of revenue was attributable to lower gross profit as a percentage of revenue in our Newborn Care business primarily in the three months ended June 30, 2016 due to unfavorable product mix, as we shipped lower margin NeoBLUE® phototherapy products that were on a shipping hold at the end of the prior quarter and increased warranty expenses compared to the same period last year.

Operating Costs

Operating costs consist of (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|-----------|------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Marketing and selling | \$ 21,237 | \$ 22,108 | \$ 41,831 | \$ 42,850 |
| Percentage of revenue | 22.1% | 24.0% | 22.8% | 23.6% |
| Research and development | \$ 7,105 | \$ 7,309 | \$ 14,907 | \$ 14,167 |
| Percentage of revenue | 7.4% | 8.0% | 8.1% | 7.8% |
| General and administrative | \$ 11,923 | \$ 11,656 | \$ 24,404 | \$ 23,208 |
| Percentage of revenue | 12.4% | 12.7% | 13.3% | 12.8% |
| Intangibles amortization | \$ 2,197 | \$ 2,174 | \$ 4,332 | \$ 3,129 |
| Percentage of revenue | 2.3% | 2.4% | 2.4% | 1.7% |
| Restructuring | \$ 1,083 | \$ 161 | \$ 1,118 | \$ 316 |
| Percentage of revenue | 1.1% | 0.2% | 0.6% | 0.2% |

Marketing and Selling

Marketing and selling expenses decreased in both an absolute sense and as a percentage of revenue for the three and six months ended June 30, 2016 as compared to the same period in 2015. This was due to a decrease in travel expenses and timing of marketing activities.

Research and Development

Research and development expenses decreased during the three months ended June 30, 2016 and increased during the six months ended June 30, 2016 compared to the same periods in 2015. The decrease during the three months ended June 30, 2016 is driven by reduced activities related to the remediation of certain deficiencies identified in our quality system. The increase during the six months ended June 30, 2016 relates to higher regulatory fees and project spending.

General and Administrative

General and administrative expense increased during the three and six months ended June 30, 2016 as compared to the same periods in 2015. This increase is attributable to changes in bad debt expense, consulting fees to improve productivity and an investment in managerial skills in Argentina.

Intangibles Amortization

Intangibles amortization increased during the six months ended June 30, 2016 and was flat during the three months ended June 30, 2016 as compared to the same periods in 2015. The increase during the first half of 2016 was due to the acquisition of GND in the first quarter of 2015 and to assigning lives to our trade names beginning in the second quarter of 2015. At that time we initiated a strategy to increase the brand strength of Natus by replacing acquired product trade names with Natus branded products over time. The implementation of this strategy places definite expected future lives on our acquired trade names which previously had indefinite lives. We assigned these trade names lives of seven years based on the timeline of our branding strategy. We will continue to assess the lives

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of these assets based on the timing and execution of this strategy. Amortization expense for trade names is recorded as a component of operating expense.

Restructuring

Restructuring expenses increased during the three and six months ended June 30, 2016 compared to the same periods in 2015. The increase was due to facility abandonment costs for offices located in Munich, Germany and Austin, Texas compared to the same periods in the prior year.

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. For the three months ended June 30, 2016 we reported nominal other income compared to other expense of \$0.4 million for the same period in 2015. For the six months ended June 30, 2016 we reported other income of \$0.5 million compared to other expense of \$1.2 million for the same period in 2015. This increase in this income for both the three and six months ended June 30, 2016 is attributable to an increase in net currency exchange gains.

Provision for Income Tax

We recorded provisions for income tax of \$3.4 million and \$6.6 million for the three and six months ended June 30, 2016, respectively. Our effective tax rate was 24.7% and 25.7% for the three and six months ended June 30, 2016, respectively. We recorded provisions for income tax of \$3.8 million and \$7.7 million for the three and six months ended June 30, 2015, respectively. Our effective tax rate was 27.7% and 29.4% for the three and six months ended June 30, 2015, respectively.

Our effective tax rate for the three and six months ended June 30, 2016 differed from the federal statutory tax rate primarily because of profits taxed in foreign jurisdictions with lower tax rates than the federal statutory rate. The decrease in the effective tax rate for the three and six months ended June 30, 2015 is primarily attributable to shifts in the geographical mix of income.

Our year-to-date results reflect the projected fiscal year 2016 effective tax rate as adjusted for the impact of any quarterly discrete events. Discrete items for the three months ended June 30, 2016 include the tax rate impact from adoption of ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting and recording certain tax true-ups. The impact from the adoption of ASU 2016-09 decreased our quarterly effective tax rate by 4.4%. Independent from the adoption of ASU 2016-09, the foreign tax true-up we recorded in this quarter increased our quarterly tax rate by 3.1%. Discrete items recorded during the three months ended June 30, 2015 increased the quarterly tax rate by 6.9%. The decrease in our quarterly effective tax rate, excluding the impact of discrete items for the three months ended June 30, 2016, compared with the three months ended June 30, 2015 is primarily attributable to forecasted shifts in the geographical mix of income.

We recorded \$0.6 million net tax expense of unrecognized tax benefits for the three months ended June 30, 2016 and \$0.6 million net tax expense for the six months ended June 30, 2016. Within the next twelve months, it is possible our uncertain tax benefit may change within a range of approximately zero to \$0.5 million. Our tax returns remain open to examinations as follows: U.S. Federal, 2012 through 2015, U.S. States 2011 through 2015 and significant foreign jurisdictions 2012 through 2015.

Liquidity and Capital Resources

Liquidity and capital resources consist of (in thousands):

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| | June 30, 2016 | December 31, 2015 |
|---|-------------------------|--------------------------|
| Cash and cash equivalents | \$ 96,284 | \$ 82,469 |
| Working capital | 168,527 | 164,248 |
| | Six Months Ended | |
| | June 30, | |
| | 2016 | 2015 |
| Net cash provided by operating activities | \$ 32,993 | \$ 19,523 |
| Net cash used in investing activities | (8,494) | (14,824) |
| Net cash used in financing activities | (8,406) | 2,258 |

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

As of June 30, 2016, we had cash and cash equivalents outside the U.S. in certain of our foreign operations of \$75.7 million. We 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 country from which the funds were repatriated.

On October 9, 2015 we entered into a Credit Agreement with Citibank, National Association (“Citibank”). Pursuant to the terms of the Credit Agreement, Citibank agrees, on a non-committed basis, to make loans to us from time to time, not to exceed at any time the aggregate principal amount of \$25.0 million. The proceeds under the Revolving Line of Credit shall be used by us for working capital and general corporate purposes. The Credit Agreement contains covenants, including covenants relating to maintenance of books and records, financial reporting and notification, compliance with laws, maintenance of properties and insurance, and limitations on guaranties, investments, issuance of debt, lease obligations and capital expenditures. The Credit Agreement provides for events of default, including failure to pay any principal or interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have no other significant credit facilities. As of June 30, 2016 we had \$10.0 million outstanding under the Credit Facility.

During the six months ended June 30, 2016 cash provided by operating activities of \$33.0 million was the result of \$19.1 million of net income, non-cash adjustments to net income of \$16.4 million, and net cash outflows of \$2.5 million from changes in operating assets and liabilities. This was primarily driven by a large decrease in accounts receivable stemming from collections made during the first half of 2016 offset by a decrease in accounts payable. Cash used in investing activities during the period was \$8.5 million and consisted primarily of cash used in the acquisition of NeuroQuest of \$4.6 million, net of cash acquired. Cash used to acquire other property and equipment was \$2.1 million. Cash used in financing activities during the six months ended June 30, 2016 was \$8.4 million and consisted of \$16.8 million for repurchases of common stock under our share repurchase program, \$2.6 million for taxes paid related to net share settlement of equity awards, and \$1.3 million for a contingent consideration payment to NicView, which we acquired in 2015, offset by proceeds from stock option exercises of \$2.2 million. In addition, during the six months ended June 30, 2016, we reported net borrowings of \$10.0 million of cash under the Credit Agreement.

During the six months ended June 30, 2015 cash provided by operating activities of \$19.5 million was the result of \$18.4 million of net income, non-cash adjustments to net income of \$10.0 million, and net cash outflows of \$9.0 million from changes in operating assets and liabilities. Cash used in investing activities during the period was \$14.8 million, and consisted of cash used to acquire GND of \$11.4 million and cash used to acquire other property and equipment of \$2.4 million. Cash provided by financing activities during the six months ended June 30, 2015 was \$2.3 million and consisted primarily of proceeds from stock options exercises and Employee Stock Purchase Program purchases and their related tax benefits of \$10.1 million, offset by \$5.5 million for repurchases of common

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stock under our share repurchase program, and \$1.6 million for taxes paid related to net share settlement of equity awards.

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, non-cancellable 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.

There are no material changes 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, 2015.

Off Balance Sheet Arrangements

Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director 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. During the six months ended June 30, 2016, we had no other off-balance sheet arrangements that had, or are reasonably likely to have, a material effect on our consolidated financial condition, results of operations, or liquidity.

Recent Accounting Pronouncements

See Note 1 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

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the following: 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 earn-out 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

During the six months ended June 30, 2016, there were no significant changes to our quantitative and qualitative disclosures about market risk. Please refer to Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk included in our Annual Report on Form 10-K for the year ended December 31, 2015 for a more complete discussion on the market risks we encounter.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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

Our management, with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our management, including our chief executive officer and chief financial officer, has concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of June 30, 2016.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the second quarter of 2016, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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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, 2015. There have been no material changes in our risks from such description.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information regarding repurchases by the Company of its common stock for the three months ended June 30, 2016.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------|-------------------------------------|---------------------------------|--|---|
| April 1, 2016 - April 30, 2016 | 48,000 | \$ 33.05 | 48,000 | \$ 23,215,701 |
| May 1, 2016 - May 31, 2016 | 130,000 | \$ 32.64 | 130,000 | \$ 18,972,857 |
| June 1, 2016 - June 30, 2016 | 52,953 | \$ 35.03 | 52,953 | \$ 17,118,170 |
| Total | 230,953 | \$ 33.27 | 230,953 | \$ 17,118,170 |

In June 2014, the Board of Directors authorized the repurchase of up to \$10 million of common stock pursuant to a stock repurchase program. In June 2015, the program was expanded to include up to an additional \$20 million of our common stock. In June 2016, the program was again expanded to include an additional \$20 million of our common stock, for an aggregate repurchase amount of \$50 million. The expiration date for the program is set for June 1, 2017.

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ITEM 6. Exhibits

(a) Exhibits

| Exhibit No. | Exhibit | Incorporated By Reference | | | |
|-------------|---|---------------------------|-------------|-----------|----------------|
| | | Filing | Exhibit No. | File Date | Filed Herewith |
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | X |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | X |
| 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 | | | | X |
| 101 | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Income, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements. | | | | X |

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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.

Dated: August 3, 2016

NATUS MEDICAL INCORPORATED

By: /s/ James B. Hawkins

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

Dated: August 3, 2016

By: /s/ Jonathan A. Kennedy

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

**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 3, 2016

/s/ James B. Hawkins

James B. Hawkins

President and 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 3, 2016

/s/ Jonathan A. Kennedy
Jonathan A. Kennedy
Senior Vice President
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, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James B. Hawkins, President and 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: President and Chief Executive Officer

Date: August 3, 2016

In connection with the Quarterly Report of Natus Medical Incorporated (the "Company") on Form 10-Q for the quarter ended June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jonathan Kennedy, Senior Vice President 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 and Chief Financial Officer

Date: August 3, 2016