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 March 31, 2021

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

For the transition period from __________ to __________

Commission file number: 000-33001

NATUS MEDICAL INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	**77-0154833**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification 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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.001 par value per share	NTUS	The Nasdaq Stock Market LLC (The Nasdaq Global Market)

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large Accelerated Filer	☒	Accelerated Filer	☐
Non-accelerated Filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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

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

The number of issued and outstanding shares of the registrant's Common Stock, $0.001 par value, as of April 30, 2021 was 34,078,412.

NATUS MEDICAL INCORPORATED

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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)

	March 31, 2021	December 31, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	$ 80,549	$ 82,082
Accounts receivable, net of allowance for doubtful accounts of $6,085 in 2021 and $6,213 in 2020	91,326	93,133
Inventories	69,467	75,650
Prepaid expenses and other current assets	24,477	20,837
Total current assets	265,819	271,702
Property and equipment, net	23,282	24,516
Operating lease right-of-use assets	10,776	11,669
Intangible assets, net	85,001	92,741
Goodwill	149,761	151,299
Deferred income tax	26,321	27,563
Other assets	20,408	20,904
Total assets	$ 581,368	$ 600,394
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 24,486	$ 23,429
Current portion of long-term debt	36,523	50,000
Accrued liabilities	45,792	44,236
Deferred revenue	23,669	21,308
Current portion of operating lease liabilities	6,006	6,779
Total current liabilities	136,476	145,752
Other liabilities	17,864	18,451
Operating lease liabilities	8,181	8,959
Long-term debt, net of current portion	—	5,840
Deferred income tax	9,915	10,298
Total liabilities	172,436	189,300
Stockholders' equity:		
Common stock, $0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 34,096,895 in 2021 and 33,911,703 in 2020	344,696	342,828
Preferred stock, $0.001 par value; 10,000,000 shares authorized; no shares issued and outstanding in 2021 and 2020	—	—
Retained earnings	73,705	71,309
Accumulated other comprehensive loss	(9,469)	(3,043)
Total stockholders' equity	408,932	411,094
Total liabilities and stockholders' equity	$ 581,368	$ 600,394

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

(in thousands, except per share amounts)

	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020
Revenue	$ 114,927	$ 109,383
Cost of revenue	46,688	44,933
Intangibles amortization	1,751	1,668
Gross profit	66,488	62,782
Operating expenses:		
Marketing and selling	28,971	30,730
Research and development	14,040	17,569
General and administrative	14,855	13,182
Intangibles amortization	3,897	3,661
Restructuring	205	871
Total operating expenses	61,968	66,013
Income (loss) from operations	4,520	(3,231)
Other expense, net	(1,656)	(1,494)
Income (loss) before benefit from income tax	2,864	(4,725)
Provision for (benefit from) income taxes	468	(1,128)
Net income (loss)	$ 2,396	$ (3,597)
Net income (loss) per share:		
Basic	$ 0.07	$ (0.11)
Diluted	$ 0.07	$ (0.11)
Weighted average shares used in the calculation of net income (loss) per share:		
Basic	33,611	33,800
Diluted	33,782	33,800

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

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

	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020
Net income (loss)	$ 2,396	$ (3,597)
Other comprehensive loss, net of tax:		
Foreign currency translation adjustment	(6,494)	(4,018)
Interest rate swap designated as a cash flow hedge	68	(175)
Other comprehensive loss, net of tax	(6,426)	(4,193)
Comprehensive loss	(4,030)	(7,790)

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

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(unaudited)
(in thousands, except per share amounts)

	Common Stock					
	Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Stockholders' Equity
Balances, December 31, 2020	**33,911,703**	**$ 342,828**	**$ 71,309**	**$ (3,043)**	**$ 411,094**
Vesting of restricted stock units	19,650	—	—	—	—
Net issuance of restricted stock awards	222,899	—	—	—	—
Stock-based compensation expense	—	3,018	—	—	3,018
Taxes paid related to net share settlement of equity awards	(57,357)	(1,150)	—	—	(1,150)
Other comprehensive loss	—	—	—	(6,426)	(6,426)
Net income	—	—	2,396	—	2,396
Balances, March 31, 2021	**34,096,895**	**$ 344,696**	**$ 73,705**	**$ (9,469)**	**$ 408,932**

	Common Stock				
	Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Stockholders' Equity
Balances, December 31, 2019	**34,148,700**	**$ 344,476**	**$ 87,922**	**$ (16,275)**	**$ 416,123**
Vesting of restricted stock units	14,033	—	—	—	—
Net issuance of restricted stock awards	162,212	—	—	—	—
Stock-based compensation expense	—	2,198	—	—	2,198
Repurchase of company stock	(465,117)	(10,495)	—	—	(10,495)
Taxes paid related to net share settlement of equity awards	(57,695)	(1,883)	—	—	(1,883)
Other comprehensive loss	—	—	—	(4,193)	(4,193)
Net loss	—	—	(3,597)	—	(3,597)
Balances, March 31, 2020	**33,802,133**	**$ 334,296**	**$ 84,325**	**$ (20,468)**	**$ 398,153**

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)

	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020
Operating activities:		
Net income (loss)	$ 2,396	$ (3,597)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for losses on accounts receivable	101	522
Depreciation and amortization	7,257	6,994
Loss on disposal of property and equipment	8	42
Warranty reserve	341	704
Share-based compensation	3,114	2,291
Loss on commencement of sales-type leases	6	295
Loss on equity method investment	136	—
Changes in operating assets and liabilities:		
Accounts receivable	4,962	15,612
Inventories	4,139	(3,443)
Prepaid expenses and other assets	(4,028)	(1,060)
Accounts payable	1,303	6,038
Accrued liabilities	1,172	(9,329)
Deferred revenue	2,732	2,190
Deferred income tax	1,064	103
Net cash provided by operating activities	24,703	17,362
Investing activities:		
Purchase of property and equipment	(731)	(3,575)
Net cash used in investing activities	(731)	(3,575)
Financing activities:		
Repurchase of common stock	—	(10,495)
Taxes paid related to net share settlement of equity awards	(1,150)	(1,883)
Principal payments of financing lease liability	(125)	(133)
Proceeds from borrowings	—	60,000
Payments on borrowings	(20,000)	(15,000)
Net cash provided by (used in) financing activities	(21,275)	32,489
Exchange rate changes effect on cash and cash equivalents	(4,230)	(2,557)
Net increase (decrease) in cash and cash equivalents	(1,533)	43,719
Cash and cash equivalents, beginning of period	82,082	63,297
Cash and cash equivalents, end of period	$ 80,549	$ 107,016
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 513	$ 637
Cash paid for income taxes	$ (320)	$ 3,492
Non-cash investing activities:		
Property and equipment included in accounts payable	$ 39	$ 131
Inventory transferred to property and equipment	$ 94	$ 196
Transfer of leased assets to sales-type leases	$ 13	$ 663

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 and Significant Accounting Policies

The accompanying interim condensed consolidated financial statements of Natus Medical Incorporated (“we,” “us,” or “our”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Except where noted below within Note 1, 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 our Annual Report on Form 10-K for the year ended December 31, 2020.

Interim financial reports are prepared in accordance with the rules and regulations of the Securities and Exchange Commission; accordingly, the reports 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. We have made certain reclassifications to the prior period to conform to current period presentation. The consolidated balance sheet as of December 31, 2020 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 our Annual Report on Form 10-K for the year ended December 31, 2020.

Operating results for the three months ended March 31, 2021 are not necessarily indicative of the results that may be expected for the year ending December 31, 2021. The accompanying condensed consolidated financial statements include our accounts and our wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Impact of COVID-19 on Our Financial Statements

The global spread and unprecedented impact of COVID-19 is complex and rapidly-evolving. On March 11, 2020, the World Health Organization declared COVID-19 a global pandemic and recommended extensive containment and mitigation measures worldwide. The outbreak has reached all of the regions in which we do business, and governmental authorities around the world have implemented numerous measures attempting to contain and mitigate the effects of the virus, including travel bans and restrictions, border closings, quarantines, shelter-in-place orders, shutdowns, limitations or closures of non-essential businesses, school closures, and social distancing requirements. The global spread of COVID-19 and actions taken in response to the virus have negatively affected workforces, customers, consumer confidence, financial markets, employment rates, consumer spending, credit markets and housing demand, caused significant economic and business disruption, volatility and financial uncertainty, and led to a significant economic downturn, including in the markets where we operate.

Various government programs have been established to provide financial relief for businesses affected by COVID-19 including the Canada Emergency Wage Subsidy ("CEWS") under the COVID-19 Economic Response Plan in Canada. We received $2.9 million for payroll subsidies under CEWS during the three months ended March 31, 2021. Our policy is to account for these subsidies in the same manner as an offset to the expense they relate to in the period in which we are reasonably assured to receive payment. For the three months ended March 31, 2021 we recognized reductions of $0.4 million in cost of sales, $ 1.3 million in marketing and selling expense, and $ 1.2 million in research and development expense in the condensed consolidated statements of operations for these subsidies. No payroll subsidies were received or recognized under CEWS in prior periods. As of March 31, 2021 we have collected all amounts recorded and continue to seek additional relief as applicable.

We have assessed various accounting estimates and other matters, including those that require consideration of forecasted financial information, in context of the unknown future impacts of COVID-19 using information that is reasonably available to us at this time. The accounting estimates and other matters we assessed include, but were not limited to, our allowance for doubtful accounts, inventory and warranty reserves, stock-based compensation, goodwill and other long-lived assets, financial assets, valuation allowances for tax assets and revenue recognition. While based on our current assessment of these estimates there was not a material impact to our consolidated financial statements as of and for the three months ended March 31, 2021, as additional information becomes available to us, our future assessment of these estimates, including our expectations at the time regarding the duration, scope and severity of the pandemic, as well as other factors, could materially and adversely impact our consolidated financial statements in future reporting periods.

Recently Adopted Accounting Pronouncements

None.

2 - Revenue

Unbilled accounts receivable ("AR") for the periods presented primarily represent the difference between revenue recognized based on the relative selling price of the related performance obligations and the contractual billing terms in the arrangements. Deferred revenue for the periods presented primarily relates to extended service contracts, installation, and training, for which the service fees are billed in advance. The associated deferred revenue is generally recognized ratably over the extended service period or when installation and training are complete.

The following table summarizes the changes in the unbilled AR and deferred revenue balances for the three months ended March 31, 2021 (in thousands):

Unbilled AR, December 31, 2020	$	1,925
Additions		69
Transferred to trade receivable		(8)
Unbilled AR, March 31, 2021	$	1,986

Deferred revenue, December 31, 2020	$	25,723
Additions		11,032
Revenue recognized		(8,332)
Deferred revenue, March 31, 2021	$	28,423

At March 31, 2021, the short-term portion of deferred revenue of $23.7 million and the long-term portion of $4.7 million are included in deferred revenue and other long-term liabilities, respectively, in the consolidated balance sheet. As of March 31, 2021, we expect to recognize revenue associated with deferred revenue of approximately $20.1 million in 2021, $5.5 million in 2022, $1.5 million in 2023, $0.9 million in 2024, and $0.4 million thereafter.

3 - Earnings Per Share

The components of basic and diluted EPS, and shares excluded from the calculation of diluted loss per share because the effect would have been anti-dilutive, are as follows (in thousands, except per share amounts):

	Three Months Ended March 31,			
	2021		2020	
Net income (loss)	$	2,396	$	(3,597)
Weighted average common shares		33,611		33,800
Dilutive effect of stock based awards		171		—
Diluted shares		33,782		33,800
Basic earnings per share	$	0.07	$	(0.11)
Diluted earnings per share	$	0.07	$	(0.11)
Shares excluded from calculation of diluted EPS		—		85

4 - Allowance for Doubtful Accounts

We estimate the lifetime allowance for doubtful, potentially uncollectible, accounts receivable upon their inception based on historical collection experience within the markets in which we operate, customer-specific information such as bankruptcy filings or customer liquidity problems, current conditions, and reasonable and supportable forecasts about the future.

Our allowance for doubtful accounts is presented as a reduction to accounts receivable on our consolidated balance sheet. When all internal efforts have been exhausted to collect the receivable, it is written off and relieved from the reserve.

The details of activity in allowance for doubtful accounts are as follows (in thousands):

	Three Months Ended March 31,	
	2021	2020
Balance, beginning of period	$ 6,213	$ 7,384
Additions charged to expense	101	522
Write-offs charged against allowance	(229)	(614)
Balance, end of period	$ 6,085	$ 7,292

5 - Inventories

Inventories consist of the following (in thousands):

	March 31, 2021	December 31, 2020
Raw materials and subassemblies	$ 18,874	$ 22,583
Work in process	3,327	2,294
Finished goods	61,977	65,695
Total inventories	84,178	90,572
Less: Non-current inventories	(14,711)	(14,922)
Inventories, current	$ 69,467	$ 75,650

As of March 31, 2021 and December 31, 2020, we have classified $ 14.7 million and $14.9 million, respectively, of inventories as other assets. This inventory consists primarily of service components used to repair products held by customers pursuant to warranty obligations and extended service contracts, including service components for products we no longer sell, inventory purchased for lifetime buys, and inventory that is turning over at a slow rate. We believe these inventories will be utilized for their intended purpose.

6 – Intangible Assets

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

	March 31, 2021				December 31, 2020			
	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	$ 110,356	$ (12,458)	$ (65,079)	$ 32,819	$ 112,138	$ (12,480)	$ (64,203)	$ 35,455
Customer related	92,411	(50)	(52,499)	39,862	94,526	(50)	(51,247)	43,229
Trade names	46,481	(3,592)	(33,047)	9,842	47,058	(3,677)	(31,890)	11,491
Internally developed software	13,281	—	(12,895)	386	13,281	—	(12,845)	436
Patents	2,748	(133)	(2,615)	—	2,810	(133)	(2,677)	—
Service agreements	1,190	—	(1,129)	61	1,190	—	(1,119)	71
Definite-lived intangible assets	$ 266,467	$ (16,233)	$ (167,264)	$ 82,970	$ 271,003	$ (16,340)	$ (163,981)	$ 90,682
Intangible assets with indefinite lives:								
Intellectual Property	$ 2,031	$ —	$ —	$ 2,031	$ 2,059	$ —	$ —	$ 2,059
Total intangible assets	$ 268,498	$ (16,233)	$ (167,264)	$ 85,001	$ 273,062	$ (16,340)	$ (163,981)	$ 92,741

Finite-lived intangible assets are amortized over their weighted average lives, which are 14 years for technology, 10 years for customer related intangibles, 7 years for trade names, 6 years for internally developed software, 13 years for patents, 2 years for service agreements and 11 years weighted average in total.

Internally developed software consists of $11.1 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 March 31,	
	2021	2020
Technology	$ 1,795	$ 1,712
Customer related	2,360	2,140
Trade names	1,483	1,466
Internally developed software	50	69
Service agreements	$ 10	$ 10
Total amortization	$ 5,698	$ 5,397

The amortization expense amounts shown above include internally developed software not held for sale of $ 24 thousand and $24 thousand for the three months ended March 31, 2021 and March 31, 2020, respectively, which is recorded within our income statement as a general and administrative operating expense. The amortization expense amounts shown above include internally developed software held for sale of $26 thousand and $45 thousand for the three months ended March 31, 2021 and March 31, 2020, respectively, which is recorded within our income statement as cost of goods sold.

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

Nine months ending December 31, 2021	$	16,276
2022		17,940
2023		15,169
2024		13,233
2025		12,619
2026		2,422
Thereafter		5,311
Total expected amortization expense	$	82,970

7 – Goodwill

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

December 31, 2020	$	151,299
Foreign currency translation		(1,538)
March 31, 2021	$	149,761

8 - Property and Equipment, net

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

	March 31, 2021		December 31, 2020	
Land	$	1,786	$	1,792
Buildings		7,144		7,365
Leasehold improvements		7,378		8,050
Finance lease right-of-use assets		2,512		2,555
Equipment and furniture		20,581		22,148
Computer software and hardware		10,257		10,246
Demonstration and loaned equipment		3,175		3,086
		52,833		55,242
Accumulated depreciation		(29,551)		(30,726)
Total	$	23,282	$	24,516

Depreciation expense of property and equipment was approximately $1.6 million and $1.7 million for the three months ended March 31, 2021 and March 31, 2020, respectively.

9 - Reserve for Product Warranties

We provide a warranty for products that is generally one year in length. In some cases, regulations may require us to provide repair or remediation beyond the typical warranty period. If any of the products contain defects, we may incur additional repair and remediation costs. Service, repair and calibration services are provided by a combination of our owned facilities and vendors on a contract basis.

We accrue estimated product warranty costs at the time of sale based on historical experience. 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 March 31, 2021, we have accrued $4.8 million for product related warranties. Our estimate of these costs is primarily based upon the number of units outstanding that may require repair and costs associated with shipping.

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

	Three Months Ended March 31,	
	2021	2020
Balance, beginning of period	$ 5,195	$ 6,404
Additions charged to expense	341	704
Utilizations	(740)	(1,271)
Balance, end of period	$ 4,796	$ 5,837

Our estimate of future product warranty costs may vary from actual product warranty costs, and any variance from estimates could impact our cost of sales, operating profits and results of operations.

10 - Share-Based Compensation

As of March 31, 2021, we have two active share-based compensation plans, the 2018 Equity Incentive Plan and the 2011 Employee Stock Purchase Plan.

The terms of all awards granted during the three months ended March 31, 2021 and the 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, 2020.

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

	Three Months Ended March 31,	
	2021	2020
Cost of revenue	$ 100	$ 75
Marketing and selling	640	469
Research and development	355	254
General and administrative	1,923	1,400
Total	$ 3,018	$ 2,198

As of March 31, 2021, unrecognized compensation expense related to the unvested portion of stock options and other stock awards was approximately $ 20.2 million, which is expected to be recognized over a weighted average period of 2.6 years.

11 - Other Income (Expense), net

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

	Three Months Ended March 31,	
	2021	2020
Interest income	$ 3	$ 24
Interest expense	(766)	(717)
Foreign currency loss	(731)	(801)
Other expense	(162)	—
Total other (expense), net	$ (1,656)	$ (1,494)

12 - Income Taxes

Our tax provision for interim periods is determined using an estimated annual effective tax rate, adjusted for discrete events arising in each respective quarter. During each interim period, we update the estimated annual effective tax rate which is subject to significant volatility due to several factors, including our ability to accurately predict the income (loss) before provision for income taxes in multiple jurisdictions, the effects of acquisitions, the integration of those acquisitions, and changes in tax law. In circumstances where we are unable to predict income (loss) in multiple jurisdictions, the actual year to date effective tax rate may be the best estimate of the annual effective tax rate for purposes of determining the interim provision for income tax.

We recorded income tax expense of $0.5 million and income tax benefit of $1.1 million for the three months ended March 31, 2021 and March 31, 2020, respectively. The effective tax rate was 16.4% and 23.9% for the three months ended March 31, 2021 and March 31, 2020, respectively. The decrease in the effective tax rate for the three months ended March 31, 2021 compared with the three months ended March 31, 2020, is primarily attributable to changes in mix of income among jurisdictions with varying tax rates and discrete items. Other significant factors impacting the current period effective tax rate included Federal and California research and development credits and non-deductible executive compensation expenses.

We recorded no changes related to unrecognized tax benefits for the three months ended March 31, 2021. Within the next twelve months, it is possible that the uncertain tax positions may change with a range of approximately zero to $0.2 million. Our tax returns remain open to examination as follows: U.S Federal, 2017 through 2020, U.S. states, 2016 through 2020, and significant foreign jurisdictions, generally 2016 through 2020.

13 - Debt and Credit Arrangements

We have a Credit Agreement with JP Morgan Chase Bank ("JP Morgan"), Citibank, NA (“Citibank”), and Wells Fargo Bank, National Association (“Wells Fargo”). During the third quarter of 2020 we amended the terms of the Credit Agreement to extend the maturity date of the original agreement, reduce the aggregate value of the revolving facility, and amend certain covenants. The amended Credit Agreement provides for an aggregate $150.0 million of secured revolving credit facility. 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, and is secured by virtually all of our assets. 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 the event has a material adverse effect. We have no other significant credit facilities.

In addition to the customary restrictive covenants listed above, the Credit Agreement also contains financial covenants that require us to maintain a certain leverage ratio and fixed charge coverage ratio, each as defined in the Credit Agreement:

- Leverage Ratio, as defined, to be no higher than 3.25 to 1.00.
- Interest Coverage Ratio, as defined, to be at least 1.75 to 1.00 at all times.

At March 31, 2021, we were in compliance with the Leverage Ratio and the Interest Coverage Ratio covenants as defined in the Credit Agreement.

During the first quarter of 2020 we drew an additional $60.0 million on our credit line as a precaution to ensure we have the necessary capital to continue to reliably serve our customers during an extended period of uncertainty of which $43.0 million was repaid by December 31, 2020. During the first quarter of 2021, we repaid $20.0 million of our outstanding debt and at March 31, 2021, we had $37.0 million outstanding under the Credit Agreement.

Pursuant to the terms of the Credit Agreement, the outstanding principal balance will bear interest at either (a) a fluctuating rate per annum equal to the Applicable Rate, as defined in the Credit Agreement, depending on our leverage ratio plus the higher of (i) the federal funds rate plus one-half of one percent per annum; (ii) the prime rate in effect on such a day; and (iii) the LIBOR rate plus one percent, or (b) a fluctuating rate per annum of LIBOR Rate plus the Applicable Rate, which ranges between 2.25% to 3.50%. The effective interest rate during the three months ended March 31, 2021 was 3.05%. The Credit Agreement matures on September 25, 2023, at which time all principal amounts outstanding under the Credit Agreement will be due and payable. As of March 31, 2021, we have classified the full outstanding debt balance of $37.0 million as short-term on our balance sheet due to our intent to repay this portion over the next twelve months.

Long-term debt consists of (in thousands):

	March 31, 2021	December 31, 2020
Revolving credit facility	$ 37,000	$ 57,000
Debt issuance costs	(477)	(1,160)
Less: current portion of long-term debt	36,523	50,000
Total long-term debt	$ —	$ 5,840

Maturities of long-term debt as of March 31, 2021 are as follows (in thousands):

	March 31, 2021	December 31, 2020
2021	$ —	$ —
2022	—	—
2023	37,000	57,000
Thereafter	—	—
Total	$ 37,000	$ 57,000

As of March 31, 2021, the carrying value of total debt approximated fair market value.

14 - Financial Instruments and Derivatives

We use interest rate swap derivative instruments to reduce earnings volatility and manage cash flow exposure resulting from changes in interest rates. These interest rate swaps apply a fixed interest rate on a portion of our expected LIBOR-indexed floating-rate borrowings. We held the following interest rate swaps as of March 31, 2021 (in thousands):

Hedged Item	Current Notional Amount	Designation Date	Effective Date	Termination Date	Fixed Interest Rate	Floating Rate	Estimated Fair Value
1-month USD LIBOR Loan	$ 15,000	May 31, 2018	June 1, 2018	September 23, 2021	2.611%	1-month USD LIBOR	$ 187
Total interest rate derivatives designated as cash flow hedge	$ 15,000						$ 187

We have designated these derivative instruments as cash flow hedges. We assess the effectiveness of these derivative instruments and record the change in the fair value of a derivative instrument designated as a cash flow hedge as unrealized gains or losses in accumulated other comprehensive income ("AOCI"), net of tax. Once the hedged item affects earnings, the effective portion of any gain or loss will be reclassified to earnings. If the hedged cash flow does not occur, or if it becomes probable that it will not occur, we will reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time.

As of March 31, 2021, we estimate that approximately $ 142.0 thousand of losses associated with the cash flow hedge, net of tax, could be reclassified from AOCI into earnings within the next twelve months.

15 - Segment, Customer and Geographic Information

We operate in one reportable segment in which we provide medical device solutions focused on the diagnosis and treatment of central nervous and sensory system disorders for patients of all ages.

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

The following tables present revenue by end market and geographic region and long-lived asset information by geographic region. Revenue is based on the destination of the shipments and long-lived assets are based on the physical location of the assets (in thousands):

	Three Months Ended March 31, 2021	2020
Consolidated Revenue:		
United States	$ 67,772	$ 68,338
International	47,155	41,045
Total	$ 114,927	$ 109,383

	Three Months Ended March 31, 2021	2020
Revenue by End Market:		
Neuro Products		
Devices and Systems	$ 53,341	$ 49,426
Supplies	15,714	15,924
Total Neuro Revenue	69,055	65,350
Newborn Care Products		
Devices and Systems	13,772	11,124
Supplies	8,403	9,691
Services	3,764	3,417
Total Newborn Care Revenue	25,939	24,232
Hearing & Balance Products		
Devices and Systems	18,771	18,560
Supplies	1,162	1,241
Total Hearing & Balance Revenue	19,933	19,801
Total Revenue	$ 114,927	$ 109,383

	March 31, 2021	December 31, 2020
Property and equipment, net:		
United States	$ 10,115	$ 10,998
Ireland	6,647	6,716
Canada	3,713	3,775
Denmark	1,613	1,787
Other countries	1,194	1,240
Total	$ 23,282	$ 24,516

During the three months ended March 31, 2021 and 2020, no single customer and no country outside the United States contributed more than 10% of our consolidated revenue.

16 - 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 derivative financial instruments described in Note 14 are measured at fair value on a recurring basis and are presented on the consolidated balance sheets at fair value. We estimate the fair value of the interest rate swaps by calculating the present value of the expected future cash flows of each swap. The calculation incorporates the contractual terms of the derivatives, observable market interest rates which are considered to be Level 2 inputs, and credit risk adjustments, if any, to reflect the counterpart's as well as our nonperformance risk. As of March 31, 2021, there have been no events of default under the interest rate swap agreement. The table below presents the fair value of the derivative financial instruments as well as the classification on the consolidated balance sheet (in thousands):

	December 31, 2020	Additions	Payments	Adjustments	March 31, 2021
Liabilities:					
Interest rate swap	$ 277	$ —	$ —	$ (90)	$ 187
Total	$ 277	$ —	$ —	$ (90)	$ 187

The following financial instruments are not measured at fair value on our consolidated balance sheet as of March 31, 2021 and December 31, 2020 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.

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

Overview

The following Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") supplements the MD&A in our Annual Report on Form 10-K for the year ended December 31, 2020. MD&A should be read in conjunction with our condensed consolidated financial 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, 2020 and the cautionary information regarding forward-looking statements at the end of this section.

Our Business

We are a leading provider of medical device solutions focused on the diagnosis and treatment of central nervous and sensory system disorders for patients of all ages.

End Markets

Our products address the below end markets:

- Neuro - Includes products and services that provide diagnostic, therapeutic and surgical solutions in neurodiagnostics, neurocritical care and neurosurgery. Neuro's comprehensive neurodiagnostic solutions include electroencephalography and long-term monitoring, Intensive Care Unit monitoring, electromyography, sleep analysis or polysomnography, and intraoperative monitoring. These solutions enhance the diagnosis of neurological conditions such as epilepsy, sleep disorders and neuromuscular diseases. Our neurocritical care solutions include management of traumatic brain injury by continuous monitoring of intracranial pressure and cerebrospinal fluid drainage, as well as cranial access kits for entry into the cranium. Our neurosurgical solutions include items such as valves, shunts and related treatment solutions for procedures involving hydrocephalus.

- Newborn Care - Includes products and services for newborn care including hearing screening, brain monitoring, eye imaging, jaundice management, and various disposable newborn care supplies.
- Hearing & Balance - The Hearing portfolio includes products for hearing assessment and diagnostics, and hearing aid fitting, including computer-based audiological, otoneurologic and vestibular instrumentation for hearing care professionals. Our Balance portfolio provides diagnosis and assessment of vestibular and balance disorders. These solutions have a complete product and brand portfolio known for its sophisticated design technology in the hearing and balance assessment markets.

Segment and Geographic Information

We operate as one operating segment and one reportable segment, which provides healthcare products, and services focused on the diagnosis and treatment of central nervous and sensory system disorders for patients of all ages. Financial information is reviewed on a consolidated basis for purposes of making operating decisions and assessing financial performance. Consolidated financial information is accompanied by disaggregated information about revenues by end market and geographic region. We do not asses the performance of our end markets or geographic regions on measures of profit or loss, or asset-based metrics. We have disclosed the revenues for each of our end markets and geographic regions to provide the reader of the financial statements transparency into our operations.

Information regarding our revenues and long-lived assets in the U.S. and in countries outside the U.S. is contained in Note 15 – 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, 2020. Revenue from Devices and Systems, Supplies, and Services, as a percent of total revenue for the three months ended March 31, 2021 and 2020, is as follows:

	Three Months Ended March 31,	
	2021	**2020**
Devices and Systems	75 %	72 %
Supplies	22 %	25 %
Services	3 %	3 %
Total	100 %	100 %

2021 First Quarter Overview

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

We experienced an increase in demand, particularly in Asia Pacific and Europe, during the first quarter compared to the same period in the prior year as recovery from the COVID-19 pandemic continues. Our consolidated revenue for the first quarter ended March 31, 2021 was $114.9 million compared to $109.4 million in the first quarter of the previous year, an increase of $5.5 million.

Our net income was $2.4 million or $0.07 per diluted share in the three months ended March 31, 2021, compared with net loss of $3.6 million or $0.11 per share in the same period in 2020. The increase in net income was the result of higher revenue due to the recovery from impact of COVID-19, in particular in international markets for Neuro products, and lower expenses compared to the prior year, driven by the timing of engineering project spend and the benefit of COVID-19 payroll relief received in Canada.

COVID-19 Update

Healthcare providers and patients continue to depend on our products and services every day. Our team members and partners are continuing to maintain our supply chain, manufacturing and delivery of our products and services. The health and welfare of our employees, our customers and our partners remain our top priority as we continue our business operations.

We have implemented safeguards in our facilities to protect team members, including social distancing practices, work from home and other measures consistent with specific regulatory requirements and guidance from health authorities. As an essential supplier of healthcare products and services, all of our manufacturing, engineering and customer support functions remain fully operational and will continue to support customers with vital supplies, service and equipment. We have taken actions to reduce costs, including reducing travel and discretionary expenses. We will continue to prioritize spending to allow continued investment in products and services that are key elements of our stated strategy for profitable growth in the years ahead.

Impact to our supply chain

Many of our materials are single source and require lengthy qualification periods. Disruptions in our supply chain could negatively impact our ability to produce and supply our finished products. We have made strategic investments in inventory to help mitigate potential supply chain disruptions. These investments include increased inventory and firm purchase orders beyond our typical timeframe in order to secure capacity at our key suppliers. To date, we have not incurred any significant supply disruptions and we believe our suppliers are positioned well to provide us with the materials we need to meet our demand. Supply appears to be stable, which could allow for the reduction of inventory levels in future quarters. The health and safety of our suppliers is also a priority for us and we have transitioned collaboration with our suppliers to online technology so that we can continue our business operations.

Liquidity

In the first quarter of 2020 we drew $60.0 million on our credit line as a precaution to ensure we have the necessary capital to continue to reliably serve our customers during an extended period of uncertainty of which $43.0 million was repaid by December 31, 2020. During the third quarter of 2020 we amended our Credit Agreement which extended the maturity date of the original agreement from September 23, 2021 to September 25, 2023, reduced the aggregate revolving credit facility from $225.0 million to $150.0 million, and amended certain covenants. During the three months ended Mach 31, 2021, we repaid $20.0 million in debt, reducing the amount outstanding under the Credit Agreement to $37.0 million, and continued to maintain a strong cash position ending the period with $80.5 million in cash.

As a result of the COVID-19 pandemic, some hospitals and clinics delayed payments for products and services and we have worked with our customers to arrange mutually acceptable payment terms during this uncertain time. We have seen revenues and margins improve since the onset of the pandemic. We continue to see our customers adapting to the COVID environment, which we believe will result in increased capital spending and continue to improve our business in 2021.

While we believe that we have sufficient liquidity to operate the Company for the foreseeable future should negative economic conditions persist for an extended period of time, we are evaluating additional measures we could take to further enhance our liquidity position.

Government Grants

Various government programs have been announced to provide financial relief for businesses affected by COVID-19 including the CEWS under the COVID-19 Economic Response Plan in Canada. We received $2.9 million for payroll subsidies under CEWS during the three months ended March 31, 2021. Our policy is to account for these subsidies in the same manner as an offset to the expense they relate to in the period in which we are reasonably assured to receive payment. For the three months ended March 31, 2021 we recognized reductions of $0.4 million of cost of sales, $1.3 million of marketing and selling expense, and $1.2 million of research and development expense in the condensed consolidated statements of operations for these subsidies. No payroll subsidies were received or recognized under CEWS in prior periods. As of March 31, 2021 we have collected all amounts recorded and continue to seek additional relief as applicable.

Impact to fair-value of intangible assets

We have reviewed the assets on our balance sheet, particularly goodwill and significant intangible assets for indications of impairment related to COVID-19 and determined that there are no indicators of impairment at this time. The values of these assets are particularly sensitive to our market cap and the long-term value of their cash flows. If these conditions change significantly, we may need to record an impairment to their value. However, any impairment charges would not require the use of cash and are excluded from the calculation of our debt covenants and, therefore, would not affect our ability to borrow under our existing credit line.

Impact to our financial systems and internal controls

To date, the COVID-19 pandemic has not had a material impact to our ability to operate our accounting and financial functions. We are staffed with approximately 150 dedicated finance, accounting and IT professionals. Our accounting and IT systems are maintained with third party support agreements and we have documented disaster recovery plans in place. Our finance, accounting and IT professionals are performing their normal functions while working from home with little to no physical presence and with no changes to our internal controls. We are confident that we can operate in this manner for an extended period of time without disruption and without significant impact to our internal controls.

Travel restrictions and use of online technology

The global Natus team is geographically diverse with multiple small locations and hundreds of employees that typically work from home in normal circumstances. We use the latest collaboration technology and have been able to transition to a company-wide work from home model without major interruption. Our manufacturing, distribution and field service operations require physical presence of certain employees as their work requires them to handle our products. In these cases, we have made adjustments to shift size and schedule and limited access to these groups by non-related employees. Our field service technicians are following our customers' requirements for distancing practices but continue to provide service where needed.

Travel restrictions have forced most customer and external partner collaboration to online technology. Using this technology has enabled us to continue operations without incident. However, in-person customer engagement as well as physical presence in laboratory settings is required for the long-term success of our company and eventually, we will need to return to traditional forms of interaction.

Application of Critical Accounting Policies

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America. 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 valuation

- Income Taxes

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, 2020, under Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations* .

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 March 31,			
	2021		2020	
Revenue	100.0	%	100.0	%
Cost of revenue	40.6	%	41.1	%
Intangibles amortization	1.5	%	1.5	%
Gross profit	57.9	%	57.4	%
Operating expenses:				
Marketing and selling	25.2	%	28.1	%
Research and development	12.2	%	16.1	%
General and administrative	12.9	%	12.1	%
Intangibles amortization	3.4	%	3.3	%
Restructuring	0.2	%	0.8	%
Total operating expenses	53.9	%	60.4	%
Income (loss) from operations	4.0	%	(3.0)	%
Other expense, net	(1.4)	%	(1.4)	%
Income (loss) before provision for income tax	2.6	%	(4.4)	%
Provision for (benefit from) income taxes	0.4	%	(1.0)	%
Net income (loss)	2.2	%	(3.4)	%

Revenues

The following table shows revenue by products during the three months ended March 31, 2021 and March 31, 2020 (in thousands):

	Three Months Ended March 31,		
	2021	2020	Change
Neuro Products			
Devices and Systems	$ 53,341	$ 49,426	8 %
Supplies	15,714	15,924	(1) %
Total Neuro Revenue	69,055	65,350	6 %
Newborn Care Products			
Devices and Systems	13,772	11,124	24 %
Supplies	8,403	9,691	(13) %
Services	3,764	3,417	10 %
Total Newborn Care Revenue	25,939	24,232	7 %
Hearing & Balance Products			
Devices and Systems	18,771	18,560	1 %
Supplies	1,162	1,241	(6) %
Total Hearing & Balance Revenue	19,933	19,801	1 %
Total Revenue	$ 114,927	$ 109,383	5 %

For the three months ended March 31, 2021, Neuro revenue increased by 6% compared to the same period last year driven by higher sales of Neuro devices in our international markets combined with strength in backlog from 2020. Revenue from Neuro supplies was down slightly from the same period last year due to lower shipments of Neurocritical Care products.

For the three months ended March 31, 2021, Newborn Care revenue increased by 6% compared to the same period last year due mainly to the sale of NICVIEW devices, which had been on ship hold during the same period last year, higher Hearing Screening device sales, and higher services revenue from our agreement with Pediatrix. These increases were partly offset by decreases in Hearing Screening supplies and Phototherapy devices due to lower births.

For the three months ended March 31, 2021, Hearing & Balance revenue remained flat compared to the same period last year with an increase in device sales partly offset by a slight decline in supplies revenue.

Revenue from domestic sales decreased to $67.8 million for the three months ended March 31, 2021 compared to $68.3 million in the three months ended March 31, 2020. The decrease in domestic revenue was mainly due to the impact of the COVID-19 pandemic on demand for supplies.

Revenue from international sales increased to $47.2 million for the three months ended March 31, 2021 compared to $41.0 million for the three months ended March 31, 2020. The increase was driven by recovery in demand, mainly for our Neuro products, following the impact of the COVID-19 pandemic in the same period last year.

Cost of Revenue and Gross Profit

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

	Three Months Ended March 31,					
	2021			2020		
Revenue	$	114,927		$	109,383	
Cost of revenue		46,688			44,933	
Intangibles amortization		1,751			1,668	
Gross profit		66,488			62,782	
Gross profit percentage		57.9	%		57.4	%

For the three months ended March 31, 2021, gross profit as a percentage of revenue increased 0.5% compared to the same period in the prior year. The increase was due to higher revenue and lower operations overhead spend partly offset by higher costs for freight and contract manufacturer fees.

Operating Costs

Operating costs consist of (in thousands):

	Three Months Ended March 31,					
	2021			2020		
Marketing and selling	$	28,971		$	30,730	
Percentage of revenue		25.2	%		28.1	%
Research and development	$	14,040		$	17,569	
Percentage of revenue		12.2	%		16.1	%
General and administrative	$	14,855		$	13,182	
Percentage of revenue		12.9	%		12.1	%
Intangibles amortization	$	3,897		$	3,661	
Percentage of revenue		3.4	%		3.3	%
Restructuring	$	205		$	871	
Percentage of revenue		0.2	%		0.8	%

Marketing and Selling

Marketing and selling expenses decreased for the three months ended March 31, 2021. The reduction was primarily driven by lower travel and tradeshow expenses due to the impact of COVID-19 restrictions partly offset by an increase in commissions expense related to higher revenue in the current quarter.

Research and Development

Research and development expenses decreased during the three months ended March 31, 2021 compared to the same period in 2020. The decrease is the result of activities in 2020 which did not recur in 2021 related to remediation and projects to comply with the European Union's adoption of the Medical Device Regulation which imposes stricter requirements for the marketing and sale of medical devices, including new quality system and post-market surveillance requirements.

General and Administrative

General and administrative expense during the three months ended March 31, 2021 increased when compared to the same period in the prior year. This increase was due to higher stock compensation and incentive compensation, partly offset by a reduction in outside service expenses.

Intangibles Amortization

Intangibles amortization remained flat during the three months ended March 31, 2021 as compared to the same period in 2020.

Restructuring

Restructuring expenses decreased during the three months ended March 31, 2021 compared to the same period in 2020. The decrease in the three months ended March 31, 2021 was primarily driven by lower severance costs and costs incurred as the result of exiting the Peloton business in 2020, which did not recur in 2021.

Other Expense, net

Other 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 March 31, 2021 we reported $1.7 million of other expense compared to $1.5 million of other expense for the same period in 2020. The increase in expense was driven by an equity method investment adjustment.

Provision for (Benefit from) Income Tax

Our tax provision for interim periods is determined using an estimated annual effective tax rate, adjusted for discrete events arising in each respective quarter. During each interim period, we update the estimated annual effective tax rate which is subject to significant volatility due to several factors, including our ability to accurately predict the income (loss) before provision for income taxes in multiple jurisdictions, the effects of acquisitions, the integration of those acquisitions, and changes in tax law. In circumstances where we are unable to predict income (loss) in multiple jurisdictions, the actual year to date effective tax rate may be the best estimate of the annual effective tax rate for purposes of determining the interim provision for income tax.

We recorded an expense from income tax of $0.5 million and a benefit for income tax of $1.1 million for the three months ended March 31, 2021 and March 31, 2020, respectively. The effective tax rate was 16.4% and 23.9% for the three months ended March 31, 2021 and March 31, 2020, respectively. The decrease in the effective tax rate for the three months ended March 31, 2021 compared with the three months ended March 31, 2020, is primarily attributable to changes in mix of income among jurisdictions with varying tax rates and discrete items. Other significant factors impacting the current period effective tax rate included Federal and California research and development credits and non-deductible executive compensation expenses.

We recorded no changes related to unrecognized tax benefits for the three months ended March 31, 2021. Within the next twelve months, it is possible that the uncertain tax positions may change with a range of approximately zero to $0.2 million. Our tax returns remain open to examination as follows: U.S Federal, 2017 through 2020, U.S. states, 2016 through 2020, and significant foreign jurisdictions, generally 2016 through 2020.

Liquidity and Capital Resources

Liquidity and capital resources consist of (in thousands):

	March 31, 2021	December 31, 2020
Cash and cash equivalents	$ 80,549	$ 82,082
Working capital	129,343	125,950

	Three Months Ended March 31,	
	2021	2020
Net cash provided by operating activities	$ 24,703	$ 17,362
Net cash used in investing activities	(731)	(3,575)
Net cash provided by (used in) financing activities	(21,275)	32,489

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 March 31, 2021, we had cash and cash equivalents outside the U.S. in certain of our international subsidiaries of $50.2 million, primarily in Canada and Ireland. We intend to permanently reinvest the cash held by our international subsidiaries except for Excel Tech Corporation and Natus Manufacturing Limited, which we intend to repatriate. A net deferred tax liability has been recorded for the potential future repatriation. If, however, a portion of permanently reinvested 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 depending on facts and circumstances at the time of distribution. 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.

We have a Credit Agreement with JP Morgan, Citibank, and Wells Fargo. During the third quarter of 2020 we amended the terms of the Credit Agreement to extend the maturity of the original agreement, reduce the aggregate value of the revolving credit facility, and amend certain covenants. The amended Credit Agreement provides for an aggregate $150.0 million of secured revolving credit facility. 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, and is secured by virtually all of our assets. 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 the event has a material adverse effect. The Credit Agreement matures on September 25, 2023, at which time all principal amounts outstanding under the Credit Agreement will be due and payable. We have no other significant credit facilities. During the first quarter of 2020 we drew an additional $60.0 million on our credit line as a precaution to ensure we have the necessary capital to continue to reliably serve our customers during an extended period of uncertainty. As of March 31, 2021, we had $37.0 million outstanding under the Credit Facility.

During the three months ended March 31, 2021 cash provided by operating activities of $24.7 million was the result of $2.4 million of net income, non-cash adjustments to net income of $11.0 million which was primarily driven by an adjustment for depreciation and amortization of $7.3 million, and net cash inflows of $11.3 million from changes in operating assets and liabilities primarily driven by reductions in accounts receivable and inventory. Cash used in investing activities during the period was $0.7 million to acquire other property and equipment. Cash used in financing activities during the three months ended March 31, 2021 was $21.3 million and consisted of repayment on borrowing of $20.0 million, $1.2 million for taxes paid related to net share settlement of equity awards, and $0.1 million for principal payments of financing lease liability.

During the three months ended March 31, 2020 cash provided by operating activities of $17.4 million was the result of $3.6 million of net loss, non-cash adjustments to net loss of $10.8 million, and net cash inflows of $10.1 million from changes in operating assets and liabilities. The non-cash adjustment to net loss was primarily driven by depreciation and amortization of $7.0 million. Cash used in investing activities during the period was $3.6 million to acquire other property and equipment. Cash provided by financing activities during the three months ended March 31, 2020 was $32.5 million and consisted of proceeds from borrowing of $60.0 million offset by repayment on borrowing of $15.0 million, $10.5 million for repurchases of common stock under our share repurchase program, $1.9 million for taxes paid related to net share settlement of equity awards, and $0.1 million for principal payments of financing lease liability.

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

- Extent to which we make acquisitions;
- Amount and timing of revenue;
- Length and severity of business disruptions caused by COVID-19;
- 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

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- 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 space, and bank debt. The following table summarizes our contractual obligations and commercial commitments as of March 31, 2021 (in thousands):

		Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Unconditional purchase obligations	$ 48,682	$ 46,418	$ 2,264	$ —	$ —
Bank debt	37,000	—	37,000	—	—
Interest payments	2,137	1,224	913	—	
Repatriation tax	6,552	311	2,111	4,130	—
Total	$ 94,371	$ 47,953	$ 42,288	$ 4,130	$ —

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

Our Credit Agreement with JP Morgan, Citibank, and Wells Fargo matures in 2023. We have recorded this obligation in the payments due in one to three years category in the table above based on the maturity date of the Agreement. As of March 31, 2021, we have classified the full outstanding debt balance of $37.0 million as short-term on our balance sheet due to our intent to repay this portion over the next twelve months.

The interest payments noted above are an estimate of expected interest payments but could vary materially based on the timing of future loan draws and payments. See Note 13 to the unaudited Condensed Consolidated Financial Statements for additional discussion on our debt and credit arrangements.

We are not able to reasonably estimate the timing of any potential payments for uncertain tax positions under ASC 740, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement 109*. As a result, the preceding table excludes any potential future payments related to our ASC 740 liability for uncertain tax positions. See Note 18 in our Annual Report filed on Form 10-K for the year ended December 31, 2020 for further discussion on income taxes and repatriation tax.

Recently Issued Accounting Pronouncements

None.

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. Forward-looking statements can be identified by the words "expects," "anticipates," "believes," "intends," "estimates," "plans," "will," "outlook" and other similar expressions. Forward-looking statements are based on management's current *plans, estimates, assumptions and projections, and speak only as of the date they are made. These forward-looking statements within Item 2 include, without limitation, statements regarding the impact of COVID-19 pandemic on our business, the sufficiency of our current cash, cash equivalents and short-term investment balances, any cash generated from operations to meet our ongoing operating and capital requirements for the foreseeable future, outcomes of new product development, improved operations performance and profitability as the result of restructuring activities, 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" referred to 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 are exposed to interest rate risk on our LIBOR-indexed floating-rate debt. We have entered into an interest rate swap agreement to effectively covert a portion of our floating-rate debt to a fixed-rate. The principal objective of the swap contract is to reduce the variability of future earnings and cash flows associated with our floating-rate debt. 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 ended December 31, 2020 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 March 31, 2021.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the first quarter of 2021, 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, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We currently are, and may from time to time become, a party to various other 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, 2020. There have been no material changes in our risks from such description.

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

None.

ITEM 5. Other Information

None

ITEM 6. Exhibits

(a) Exhibits

		Incorporated By Reference			
Exhibit No.	Exhibit	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 Natus Medical Incorporated's Quarterly Report on Form 10-Q for the quarter ended March 31, 2021, 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
104	The cover page from Natus Medical Incorporated's Quarterly Report on Form 10-Q for the quarter ended March 31, 2021, formatted in Inline XBRL (included as Exhibit 101).				X

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:	May 7, 2021	By:	/s/ Jonathan A. Kennedy **Jonathan A. Kennedy** **President and Chief Executive Officer** **(Principal Executive Officer)**
Dated:	May 7, 2021	By:	/s/ B. Drew Davies **B. Drew Davies** **Executive Vice President and** **Chief Financial Officer** **(Principal Financial and Accounting Officer)**

EXHIBIT 31.1

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

I, Jonathan A. 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: May 7, 2021

/s/ Jonathan A. Kennedy

Jonathan A. Kennedy
President and Chief Executive Officer

EXHIBIT 31.2

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

I, B. Drew Davies, 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: May 7, 2021

/s/ B. Drew Davies
B. Drew Davies
Executive Vice President
and Chief Financial Officer

EXHIBIT 32.1

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 March 31, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jonathan A. Kennedy, 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/ Jonathan A. Kennedy
Print Name: Jonathan A. Kennedy
Title: President and Chief Executive Officer
Date: May 7, 2021

In connection with the Quarterly Report of Natus Medical Incorporated (the “Company”) on Form 10-Q for the quarter ended March 31, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, B. Drew Davies, Executive 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/ B. Drew Davies
Print Name: B. Drew Davies
Title: Executive Vice President and Chief Financial Officer
Date: May 7, 2021