NATUS MEDICAL INC
Form 10-Q
August 07, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

¨ **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.)**

1501 Industrial Road, San Carlos, CA 94070

(Address of principal executive offices) (Zip Code)

(650) 802-0400

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of issued and outstanding shares of the registrant s Common Stock, $0.001 par value, as of July 31, 2009 was 28,351,841.

Table of Contents

NATUS MEDICAL INCORPORATED

TABLE OF CONTENTS

		Page No.
PART I.	**FINANCIAL INFORMATION**	3
Item 1.	Financial Statements	3
	Condensed Consolidated Balance Sheets as of June 30, 2009 and December 31, 2008 (unaudited)	3
	Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2009 and 2008 (unaudited)	4
	Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and 2008 (unaudited)	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	21
Item 4.	Controls and Procedures	22
PART II.	**OTHER INFORMATION**	22
Item 1.	Legal Proceedings	22
Item 1A.	Risk Factors	22
Item 4.	Submission of Matters to a Vote of Security Holders	32
Item 6.	Exhibits	32
Signatures		33

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share amounts)

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 67,683	$ 56,915
Short-term investments	866	
Accounts receivable, net of allowance for doubtful accounts of $1,903 in 2009 and $1,126 in 2008	34,019	36,242
Inventories	24,021	25,009
Prepaid expenses and other current assets	3,179	3,554
Deferred income tax	4,082	3,928
Total current assets	133,850	125,648
Property and equipment, net	13,990	14,002
Intangible assets	55,762	57,729
Goodwill	60,995	60,858
Other assets		385
Total assets	$ 264,597	$ 258,622
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,357	$ 7,375
Current portion of long-term debt	178	206
Accrued liabilities	12,282	11,895
Deferred revenue	3,478	3,836
Total current liabilities	23,295	23,312
Long-term liabilities:		
Long-term debt	1,021	1,082
Other liabilities	4,354	4,586
Deferred income tax	3,308	3,148
Total liabilities	31,978	32,128
Stockholders equity:		
Common Stock, $0.001 par value, 120,000,000 shares authorized; shares issued and outstanding 28,323,029 in 2009 and 27,959,919 in 2008	247,675	245,476
Accumulated deficit	(2,219)	(5,342)
Accumulated other comprehensive loss	(12,837)	(13,640)

Total stockholders equity	232,619	226,494
Total liabilities and stockholders equity	$ 264,597	$ 258,622

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

Table of Contents

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(in thousands, except per share amounts)

	Three months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	$ 37,263	$ 39,862	$ 70,620	$ 76,721
Cost of revenue	14,370	15,374	27,419	29,379
Gross profit	22,893	24,488	43,201	47,342
Operating expenses:				
Marketing and selling	10,251	9,180	20,238	19,056
Research and development	3,950	4,068	7,664	7,895
General and administrative	5,270	5,440	10,774	10,296
Total operating expenses	19,471	18,688	38,676	37,247
Income from operations	3,422	5,800	4,525	10,095
Other income, net	387	386	513	386
Income before provision for income tax	3,809	6,186	5,038	10,481
Provision for income tax	1,473	2,419	1,915	4,087
Net income	$ 2,336	$ 3,767	$ 3,123	$ 6,394
Earnings per share:				
Basic	$ 0.08	$ 0.16	$ 0.11	$ 0.28
Diluted	$ 0.08	$ 0.15	$ 0.11	$ 0.26
Weighted average shares used in the calculation of earnings per share:				
Basic	27,644	24,248	27,625	23,000
Diluted	28,276	25,514	28,208	24,253

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

Table of Contents

NATUS MEDICAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)

	Six Months Ended June 30,	
	2009	**2008**
Operating activities:		
Net income	$ 3,123	$ 6,394
Adjustments to reconcile net income to net cash provided by operating activities:		
Accounts receivable reserves	1,331	306
Excess tax benefits on the exercise of options	(12)	(702)
Depreciation and amortization	4,440	2,971
Warranty reserves	639	250
Loss on disposal of property and equipment		46
Share-based compensation	1,773	1,423
Changes in operating assets and liabilities:		
Accounts receivable	893	(1,247)
Inventories	987	(1,331)
Prepaid expenses and other assets	564	409
Accounts payable	6	(1,051)
Accrued liabilities and deferred revenue	163	(2,457)
Net cash provided by operating activities	13,907	5,011
Investing activities:		
Cash paid for business acquisitions and earnout obligations, net of cash acquired	(998)	(6,764)
Purchases of property and equipment	(2,080)	(1,757)
Capitalized software development costs	(377)	(738)
Purchases of marketable securities	(866)	(11,013)
Net cash used in investing activities	(4,321)	(20,272)
Financing activities:		
Proceeds from issuance of common stock, net of issuance costs		99,470
Proceeds from stock option exercises and ESPP purchases	414	1,542
Excess tax benefits upon the exercise of options	12	702
Borrowings on credit facility		6,000
Payments on borrowings	(89)	(39,022)
Net cash provided by financing activities	337	68,692
Exchange rate effect on cash and cash equivalents	845	349
Net increase in cash and cash equivalents	10,768	53,780
Cash and cash equivalents, beginning of period	56,915	11,916
Cash and cash equivalents, end of period	$ 67,683	$ 65,696

Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 25	$ 955
Cash paid for income taxes	$ 129	$ 3,077
Non-cash investing activities:		
Acquisition-related earnout obligations included in accrued liabilities	$ 19	$ 772

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

Table of Contents

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, or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Except as updated below, the accounting policies followed in the preparation of the interim condensed consolidated financial statements are consistent in all material respects with those presented in Note 1 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

Interim financial reports are prepared in accordance with the rules and regulations of the Securities and Exchange Commission; accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. The interim financial information is unaudited, but reflects all normal adjustments that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. 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.

Comprehensive Income

Comprehensive income is comprised of net income and gains or losses resulting from currency translations of foreign investments. The details of comprehensive income are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income	$ 2,336	$ 3,767	$ 3,123	$ 6,394
Foreign currency translation adjustment	665	92	803	(1,604)
Unrealized loss on available for sale securities		(1)		(1)
Comprehensive income	$ 3,001	$ 3,858	$ 3,926	$ 4,789

Stockholders Equity

The details of changes in stockholders equity are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Balance, beginning of period	$ 228,243	$ 118,039	$ 226,494	$ 115,718
Net income	2,336	3,767	3,123	6,394
Proceeds from stock option exercises and ESPP	408	1,075	414	1,542
Proceeds from issuance of common stock		99,470		99,470
Share-based compensation expense	955	702	1,773	1,423
Tax effect of option exercises	12	500	12	702
Foreign currency translation adjustment	665	91	803	(1,605)
Balance, end of period	$ 232,619	$ 223,644	$ 232,619	$ 223,644

Foreign Currency

Effective January 1, 2009, the Company s Canadian subsidiary, Xltek changed its functional currency to the U.S. dollar. The change in functional currency reflects the fact that Xltek now conducts the majority of its business transactions in U.S. dollars and maintains a significant portion of its balance sheet in U.S. dollar denominated accounts.

Table of Contents

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. (SFAS) 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a Replacement of FASB Statement No. 162*. SFAS 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. SFAS 168 is effective for our September 30, 2009 condensed consolidated financial statements. SFAS 168 does not change GAAP and will not have a material impact on our condensed consolidated financial statements.

In May 2009, the FASB issued of SFAS 165, *Subsequent Events*. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. As of this date we have adopted SFAS 165 and have evaluated subsequent events through the date of this filing.

In April 2009, the FASB issued Staff Position (FSP) FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* to require disclosures about fair value of financial instruments in interim period financial statements of publicly traded companies and in summarized financial information required by APB Opinion No. 28, *Interim Financial Reporting*. FSP FAS 107-1 and APB 28-1 are effective for interim and annual reporting periods ending after June 15, 2009. See Note 12.

In April 2009, the FASB issued FSP FAS 141R-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, which amends the guidance in SFAS 141R to require contingent assets acquired and liabilities assumed in a business combination to be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the measurement period. If fair value cannot be reasonably estimated during the measurement period, the contingent asset or liability would be recognized in accordance with SFAS 5, *Accounting for Contingencies*, and FASB Interpretation (FIN) 14, *Reasonable Estimation of the Amount of a Loss*. Further, this FSP eliminated the specific subsequent accounting guidance for contingent assets and liabilities from SFAS 141R, without significantly revising the guidance in SFAS 141. However, contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination would still be initially and subsequently measured at fair value in accordance with SFAS 141R. This FSP is effective for all business acquisitions occurring on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of FSP FAS 141R-1 did not have any substantive impact on our condensed consolidated financial statements or related footnotes.

In April 2008, the FASB issued FSP 142-3, *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS 142, *Goodwill and Other Intangible Assets*. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The adoption of FSP 142-3 did not have a material impact on our financial statements.

In February 2008, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The fair value measurement election is irrevocable and subsequent changes in fair value must be recorded in earnings. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option is elected would be reported in earnings. We adopted SFAS 159 effective January 1, 2008 and have elected not to measure any financial instruments or other items at fair value.

In December 2007, the FASB issued SFAS 141R (revised 2007), *Business Combinations*, which replaces SFAS 141. SFAS 141R expands the definition of a business combination and requires the fair value of the purchase price of an acquisition, including the issuance of equity securities, to be determined on the acquisition date. SFAS 141R also requires that all assets, liabilities, contingent consideration and contingencies of an acquired business to be recorded at fair value at the acquisition date. In addition, SFAS 141R requires that acquisition costs generally be expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period that impacts income tax expense. SFAS 141R is effective for fiscal years beginning after December 15, 2008 with early adoption prohibited. We adopted SFAS 141R at the beginning of fiscal 2009 and will change our accounting treatment for business combinations on a prospective basis.

Table of Contents

In September 2007, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. It does not require any new fair value measurements, but does require expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. SFAS 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FSP 157-2, *Effective Date of FASB Statement No. 157*. FSP 157-2 delayed, for one year, the effective date of SFAS 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed in the financial statements on at least an annual basis. The implementation of SFAS 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on our consolidated financial position and results of operations. We have disclosed the fair value of our financial assets in Note 12. We are currently assessing the impact of adopting FAS 157 for nonfinancial assets and nonfinancial liabilities on our consolidated financial position and results of operations.

2 - Business Combinations, Goodwill, and Intangible Assets

Neurocom

On October 2, 2008 we completed the acquisition of all of the outstanding shares of Neurocom International, Inc. (Neurocom) for $18.2 million including direct costs of the acquisition. Neurocom, based in Clackamas, Oregon, develops and markets computerized systems for the assessment and rehabilitation of balance and mobility disorders. The acquisition added to our growth opportunities by broadening the product offerings in our neurology business.

Valuing certain components of the acquisition, including primarily accrued warranty costs and other accrued expenses, required us to make estimates that may be adjusted in the future; consequently, the purchase price allocation is considered preliminary.

Schwarzer Neurology

We acquired Schwarzer Neurology, a division of Schwarzer GmbH, on July 2, 2008 for EUR 4.5 million, or approximately $7.0 million including direct costs of the acquisition. Schwarzer Neurology develops and markets computer-based electrodiagnostic systems and disposable supplies used by medical practitioners to aid in the detection, diagnosis, and monitoring of neurologic disorders. The acquisition broadened our product offerings in the EEG market, allowing us to further leverage its international distribution organization.

Valuing certain components of the acquisition, including primarily inventory, accrued warranty costs, and other accrued expenses, required us to make estimates that may be adjusted in the future; consequently, the purchase price allocation is considered preliminary.

We are obligated to make additional payments pursuant to an earnout provision in the purchase agreement based on the achievement of certain revenue targets. The maximum potential future amount payable under this provision is EUR 450,000 or approximately $630,000 if the maximum target sales are achieved during the period July 1, 2009 through September 30, 2009. To date, we have not recorded additional purchase consideration as a result of this provision.

Sonamed

We acquired Sonamed Corporation (Sonamed) on May 27, 2008, for $9.0 million including direct costs of the acquisition. In June 2008 we transitioned substantially all of the operations of Sonamed to our Bio-logic facility in Mundelein, Illinois. The acquisition expanded our product offerings in newborn hearing screening.

Olympic

We acquired privately held Olympic Medical on October 16, 2006 for $16.9 million. To date we have recorded $1.5 million of additional purchase consideration pursuant to an earnout provision in the purchase agreement based on the achievement of certain revenue targets for sales of the Olympic Cool-Cap. At June 30, 2009 the maximum potential future amount payable under this provision, based on sales results from January 1, 2009 through December 31, 2009, is $1.5 million.

Goodwill

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

Balance, January 1, 2009	$ 60,858
Purchase accounting adjustments	152
Adjustments associated with earnout provisions	19
Change in foreign currency exchange rates	(34)
Balance, June 30, 2009	$ 60,995

Table of Contents

Amortization of Intangible Assets Acquired Through Business Combinations

Amortization of intangible assets associated with our business combinations was $998,000 and $2.0 million for the three and six months ended June 30, 2009, respectively, and $919,000 and $1.8 million for the three and six months ended June 30, 2008, respectively.

Capitalized Software Development Costs

Pursuant to SFAS 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*, we had no capitalized costs during the three and six months ended June 30, 2009, and $134,000 during the three and six months ended June 30, 2008, respectively.

Pursuant to FASB Statement of Position No (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, we capitalized software development costs of $169,000 and $343,000 during the three and six months ended June 30, 2009, respectively, and $400,000 and $786,000 during the three and six months ended June 30, 2008, respectively.

We report capitalized software development costs as a component of intangible assets. Amortization of capitalized software development costs was $120,000 and $252,000 during the three and six months ended June 30, 2009, respectively, with no amortization in the 2008 respective periods.

3 - Basic and Diluted Earnings Per Common Share

Earnings per share is computed in accordance with SFAS 128, *Earnings Per Share.* Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share is based upon the weighted average number of common shares outstanding and dilutive common stock equivalents outstanding during the period. Common stock equivalents are options granted and shares of restricted stock issued under our stock awards plans and are calculated under the treasury stock method. Common equivalent shares from unexercised stock options and restricted stock are excluded from the computation when there is a loss as their effect is anti-dilutive, or if the exercise price of such options is greater than the average market price of the stock for the period.

For the three and six months ended June 30, 2009, common stock equivalents of 631,443 and 582,538 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share. For the three and six months ended June 30, 2009, common stock equivalents of 1,972,024 and 1,671,547 shares, respectively, were excluded from the calculation of diluted earnings per share because the exercise price of such options was greater than the average market price of the stock for the periods. For the three and six months ended June 30, 2008, common stock equivalents of 1,266,090 and 1,253,111 shares, respectively, were included in the weighted average shares outstanding used to calculate diluted earnings per share. For the three and six months ended June 30, 2008, common stock equivalents of 178,398 and 378,936 shares, respectively, were excluded from the calculation of diluted earnings per share because the exercise price of such options was greater than the average market price of the stock for the periods.

4 - Inventories

Inventories consist of the following (in thousands):

	June 30, 2009	December 31, 2008
Raw materials and subassemblies	$ 13,268	$ 13,051
Finished goods	10,753	11,958
Total	$ 24,021	$ 25,009

Work in process represents an immaterial amount in all periods presented.

Table of Contents

5 - Property and Equipment

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

	June 30, 2009	December 31, 2008
Land	$ 3,480	$ 3,480
Building	4,766	4,766
Leasehold improvements	963	963
Office furniture and equipment	8,243	6,406
Computer software and hardware	4,852	4,609
Demonstration and loaned equipment	4,620	4,620
	26,924	24,844
Accumulated depreciation	(12,934)	(10,842)
Total	$ 13,990	$ 14,002

Depreciation and amortization expense of property and equipment was $792,000 and $2.1 million for the three and six months ended June 30, 2009, respectively, and was $583,000 and $1.2 million for the three and six months ended June 30, 2008, respectively.

6 - Reserve for Product Warranties

We provide a warranty on all medical device products that is generally one year in length. We also sell extended service agreements on our medical device products. Service for domestic customers is provided by Company-owned service centers that perform all service, repair and calibration services. Service for international customers is provided by a combination of Company-owned facilities and third-party vendors on a contract basis.

We have accrued a warranty reserve, included in accrued liabilities on the accompanying condensed consolidated balance sheets, for the expected future costs of servicing products during the initial warranty period. Amounts are added to the reserve on a per-unit basis by reference to historical experience in honoring warranty obligations. On new products, where we do not have historical experience of the cost to honor warranties, additions to the reserve are based on a combination of factors including the standard cost of the product and other judgments, such as the degree to which the product incorporates new technology. As warranty costs are incurred, the reserve is reduced.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Balance, beginning of period	$ 1,023	$ 976	$ 1,076	$ 1,000
Warranty accrued for the period	401	129	639	250
Repairs for the period	(396)	(167)	(687)	(312)
Balance, end of period	$ 1,028	$ 938	$ 1,028	$ 938

7 - Share-Based Compensation

At June 30, 2009, we have the following plans that give rise to share-based compensation: (i) two active stock option plans, the Amended and Restated 2000 Stock Awards Plan and the 2000 Director Option Plan, and (ii) the 2000 Employee Stock Purchase Plan. The terms of awards granted during the six months ended June 30, 2009 and our methods for determining grant-date fair value of the awards were consistent with those described in the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Cost of revenue	$ 50	$ 80	$ 91	$ 167
Marketing and sales	222	165	413	329
Research and development	37	66	72	171
General and administrative	646	391	1,197	756
Total	$ 955	$ 702	$ 1,773	$ 1,423

Table of Contents

As of June 30, 2009, unrecognized compensation related to the unvested portion of our stock options and other stock awards was approximately $13.3 million, which is expected to be recognized over a weighted average period of 3.2 years.

Stock Options

Activity in our stock option plans during the six months ended June 30, 2009 is as follows:

	Shares	Weighted Average Exercise Price	Weighted-average remaining contractual life (years)	Aggregate intrinsic value ($,000s)
Outstanding, beginning of period	2,876,072	$ 9.97		
Granted	668,600	$ 10.67		
Exercised	(2,275)	$ 6.56		
Cancelled	(22,479)	$ 15.97		
Outstanding, end of period	3,519,918	$ 10.07	4.67	$ 9,701
Exercisable, end of period	2,325,949	$ 8.32	4.36	$ 9,194

As of June 30, 2009, the grant date weighted average fair value of stock options granted in 2009 was $3.65 per share using the Black-Scholes option pricing model. The intrinsic value of options exercised during the six months ended June 30, 2009 was $11,056.

As of June 30, 2009, there were: (a) 3,315,707 options vested and expected to vest with a weighted average exercise price of $9.91, an intrinsic value of $9.6 million, and a weighted average remaining contractual term of 4.61 years.

Restricted Stock Awards

Activity in our stock plans related to restricted stock awards during the six months ended June 30, 2009 is as follows:

	Shares	Weighted-average grant date fair value	Remaining cost expected to be recognized ($,000s)
Unvested, beginning of period	337,518	$ 17.52	
Granted	312,700	$ 10.69	
Vested	(16,550)	$ 19.86	
Forfeited	(7,000)	$ 18.52	
Unvested, end of period	626,668	$ 14.04	$ 8,239

Of the shares awarded, 270,200 were awarded to U.S. employees of the Company that vest 50% upon the second anniversary of the vesting start date and 25% upon each of the third and fourth anniversaries of the vesting start date, and 42,500 shares were granted to non-employee directors of the Company that vest on the first anniversary of the grant date.

Restricted Stock Units

Activity in our stock plans related to the award of restricted stock units during the six months ended June 30, 2009 is as follows:

	Shares	Weighted-average remaining contractual life (years)	Aggregate intrinsic value ($,000 s)
Outstanding, beginning of period	35,500		
Awarded	49,100		
Released			
Forfeited			
Outstanding, end of period	84,600	2.29	$ 966

Table of Contents

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

8 - Other income (expense), net

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Investment income	$ 73	$ 229	$ 178	$ 367
Interest expense	(99)	(241)	(113)	(786)
Foreign currency exchange gain (loss)	(38)	214	(24)	625
Other	451	184	472	180
Total other income (expense), net	$ 387	$ 386	$ 513	$ 386

9 - Income Taxes

Provision for Income Tax

We recorded a provision for income tax of $1.5 million and $1.9 million for the three and six months ended June 30, 2009, respectively. Our effective tax rate was 38.7% and 38.0% for the three and six months ended June 30, 2009, respectively.

We recorded a provision for income tax of $2.4 million and $4.1 million for the three and six months ended June 30, 2008, respectively. Our effective tax rate was 39.1% and 39.0% for the three and six months ended June 30, 2008, respectively.

Deferred Income Taxes

We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes*, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax assets will not be realized. A valuation allowance is not provided for the majority of our deferred tax assets, as we believe that it is more likely than not that those deferred tax assets will be fully realized.

Uncertain Tax Positions

We have cumulatively accrued approximately $588,000 for estimated interest and penalties related to uncertain tax positions at June 30, 2009. We recorded approximately $51,000 and $102,000 of interest and penalties related to unrecognized tax positions as a component of income tax expense during the three and six months ended June 30, 2009, respectively and $69,000 and $138,000 during the three and six months ended June 30, 2008, respectively.

Our tax returns remain open to examination as follows: U.S. federal, 2004 through 2008; U.S. states, generally 2003 through 2008; significant foreign jurisdictions, generally 2005 through 2008.

10 - Debt and Credit Arrangements

Long-term borrowings are comprised of the following (2009 and 2008 columns in thousands):

	June 30, 2009	December 31, 2008
Term loan $2.9 million Canadian (CAD), interest at cost of funds plus 2.5%, due September 15, 2014 with principle repayable in monthly installments of $16,000 until August 15, 2014 and one final payment of $404,000 collateralized by a first lien on land and building owned by Xltek	$ 1,141	$ 1,220
Term loan CAD $300,000, interest at cost of funds plus 2.5% due November 15, 2010 with principle repayable in monthly installments of $2,000 until October 10, 2010 and one final payment of $36,000 collateralized by various assets of Xltek	58	68
Total long-term debt (including current portion)	1,199	1,288
Less: current portion of long-term debt	(178)	(206)
Total long-term debt	$ 1,021	$ 1,082

Table of Contents

On September 2, 2008, we executed a second amendment to our Amended and Restated Credit Agreement (the Second Amendment) with Wells Fargo Bank, National Association (Wells Fargo). The Second Amendment increased the borrowing limit of our revolving line of credit to $25 million and made other changes to the terms of the credit facility. Additional revisions to the credit facility were executed in February 2009 and June 2009. The credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events, and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in all of our assets. As of June 30, 2009 there were no outstanding borrowings on the credit facility.

11 - Segment, Customer and Geographic Information

We operate in one reportable segment in which we provide healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility 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 resell our products to end-users or sub-distributors.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue:				
United States	$ 25,709	$ 28,687	$ 48,687	$ 53,427
Foreign countries	11,554	11,175	21,933	23,294
Totals	$ 37,263	$ 39,862	$ 70,620	$ 76,721

	June 30, 2009	December 31, 2008
Long-lived assets:		
United States	$ 7,236	$ 7,579
Foreign countries	6,754	6,423
Totals	$ 13,990	$ 14,002

Long-lived assets consist principally of property and equipment (net). During the three and six months ended June 30, 2009, no single customer or foreign country contributed to more than 10% of revenue, and revenue from services was less than 10% of revenue.

During the three and six months ended June 30, 2009, respectively, revenue from devices and systems was $20.7 million and $39.8 million, respectively, while revenue from supplies and services was $15.8 million and $29.4 million, respectively.

12 - Fair Value of Financial Instruments

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

	Fair Value as of	Fair Value Measurements as of June 30, 2009

	June 30, 2009	Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	$ 48,437		$ 48,437	
Guaranteed investment certificate	866		866	
Total	$ 49,303		$ 49,303	

Table of Contents

	Fair Value as of December 31, 2008	Fair Value Measurements as of December 31, 2008 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Bank money market investments	$ 45,905		$ 45,905	
Embedded derivatives, net	(122)		(122)	
Total	$ 45,783		$ 45,783	

In accordance with SFAS 157, *Fair Value Measurements*, Level 1 evaluations are based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Level 2 evaluations are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. Bank money market accounts have a net asset value of $1.00 per share and are classified as Level 2 assets. Level 3 evaluations are based on assets and liabilities for which there are no observable inputs that are significant to the overall fair value measurement.

13 - Subsequent Events

We evaluated all subsequent events from the date of the balance sheet through August 7, 2009, which represents the date these financial statements are being filed with the SEC. Except as noted below there were no events or transactions occurring during this subsequent event reporting period which require recognition or disclosure in the financial statements.

Acquisition of Hawaii Medical, LLC

On July 2, 2009, we acquired Hawaii Medical, LLC for a cash price of $2.9 million, with the potential for additional consideration depending upon the achievement of certain revenue targets. Hawaii Medical, which manufactures and markets single-use disposable products sold into the nursery and neonatal intensive care unit (NICU) in hospitals, reported revenue of approximately $3.2 million in the 12 months ended June 30, 2009, selling substantially all of their products through a single national distributor in North America. We expect to transition those sales to our existing newborn-care direct sales force during the third quarter of 2009 and to launch these products internationally in the fourth quarter.

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

Natus®, AABR®, ABaer®, ALGO®, AOAE®, AuDX®, Balance Manager®, Balance Master®, Biliband®, Bio-logic®, Ceegraph®, CHAMP®, Cochlea Scan®, Cool Cap®, Ear Couplers®, Echo Screen®, EquiTest®, Fischer-Zoth®, Flexicoupler®, MASTER®, Navigator®, neoBLUE®, NeuroWorks®, Oxydome®, Sleepscan®, Smart Scale®, Traveler®, Warmette® and VAC PAC® are registered trademarks of Natus Medical Incorporated. Accuscreen , Bili-Lite Pad , Bili-Lite , Biomark , Circumstraint , Coherence , Deltamed , inVision , MiniMuffs , Neometrics and Smartpack are non-registered trademarks of Natus. Solutions for Newborn Care℠ is a non-registered service mark of Natus. Xltek®, Neuromax® and Sleeprite® are registered trademarks of Excel Tech Ltd.

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, 2008 of Natus Medical Incorporated (Natus, we, us, or our Company), and presumes that readers have read or have access to the discussion and analysis in our Annual Report. Management s discussion and analysis should be read in conjunction with our condensed consolidated financial statements and accompanying footnotes, the discussion of certain risks and uncertainties contained in Part II, Item 1A of this report, and the cautionary information regarding forward-looking statements at the end of this section. MD&A includes the following sections:

Our Business. A general description of our business;

2009 Second Quarter Overview. A summary of key information concerning the financial results for the three months ended June 30, 2009;

Table of Contents

Application of Critical Accounting Policies. A discussion of the accounting policies that are most important to the portrayal of our financial condition and results of operations and that require significant estimates, assumptions, and judgments;

Results of Operations. An analysis of our results of operations for the periods presented in the financial statements;

Liquidity and Capital Resources. An analysis of capital resources, sources and uses of cash, investing and financing activities, off-balance sheet arrangements, contractual obligations and interest rate hedging;

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

Cautionary Information Regarding Forward-Looking Statements. Cautionary information about forward-looking statements.

Business

Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatalogy, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, and software systems for managing and tracking disorders and diseases for public health laboratories.

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. The businesses we have acquired include Neometrics in 2003, Fischer-Zoth in 2004, Bio-logic, Deltamed, and Olympic in 2006, Xltek in 2007, Sonamed Corporation, Schwarzer Neurology, a division of Schwarzer GmbH, and Neurocom International, Inc. in 2008 and Hawaii Medical in July 2009.

Product Families

We categorize our products into the following product families, which are more fully described in our Annual Report on Form 10-K for the year ended December 31 2008:

Hearing Includes products for newborn hearing screening and diagnostic hearing assessment.

Monitoring Systems for Neurology Includes products for diagnostic electroencephalography (EEG), diagnostic sleep analysis (PSG), electromyography (EMG), intra-operative monitoring (IOM), newborn brain monitoring, and assessment of balance and mobility disorders.

Newborn Care Includes products for the treatment of brain injury and jaundice in newborns.

Segment and Geographic Information

We operate in one reportable segment in which we provide healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders and balance and mobility 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 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 11 *Segment, Customer and Geographic Information* of our condensed consolidated financial statements included in this report.

Table of Contents

Revenue by Product Category

We generate our revenue either from sales of Devices and Systems, which are generally non-recurring, and from related Supplies and Services, which are generally recurring. The products that are attributable to these categories are described in our Annual Report on Form 10-K for the year ended December 31, 2008. Revenue from Devices and Systems, and Supplies and Services, as a percent of total revenue for the three and six months ended June 30, 2009 and 2008 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Devices and Systems	56%	60%	56%	61%
Supplies and Services	42%	38%	42%	37%
Other	2%	2%	2%	2%
Total	100%	100%	100%	100%

During the three and six months ended June 30, 2009, no single customer or foreign country contributed to more than 10% of revenue, and revenue from services was less than 10% of revenue.

2009 Second Quarter Overview

Our revenue decreased 7% to $37.3 million in the second quarter ended June 30, 2009, compared to $39.9 million reported in the comparable quarter of the previous year. Net income decreased 38% to $2.3 million, or $0.08 per diluted share, for the second quarter of 2009, compared with net income of $3.8 million, or $0.15 per diluted share, for the second quarter of 2008.

The severe worldwide economic downturn that started to impact our business in December 2008 continued to influence our results for the second quarter of 2009. In the quarter, hospitals in the United States reduced expenditures on capital equipment, but the decrease was smaller than the first quarter of 2009. This impacted sales of all the Company s product lines except our newborn care products. We saw a small increase in capital equipment spending outside the United States. Revenue from our neurology, balance and mobility, hearing diagnostic, and newborn hearing equipment products were all down by at least 14% year over year. We believe this trend will continue through the remainder of the year, but we believe the reduction in capital equipment purchases has stabilized.

Subsequent Event

On July 2, 2009, we acquired Hawaii Medical LLC for a cash price of $2.9 million, with the potential for additional consideration depending upon the achievement of certain revenue targets. Hawaii Medical, which manufactures and markets single-use disposable products sold into the nursery and neonatal intensive care unit (NICU) in hospitals, reported revenue of approximately $3.2 million in the twelve months ended June 30, 2009, selling substantially all of their products through a single national distributor in North America. We expect to transition those sales to our existing newborn-care direct sales force during the third quarter of 2009 and launch these products internationally in the fourth 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. The use of different estimates, assumptions, or judgments could have a material affect on the reported amounts of assets, liabilities, revenue, expenses, and related disclosures as of the date of the financial statements and during the reporting period:

Revenue recognition

Allowance for doubtful accounts

Inventory is carried at the lower of cost or market value

Carrying value of intangible assets and goodwill

Liability for product warranties

Share-based compensation

Table of Contents

These critical accounting policies are described in more detail in our Annual Report on Form 10-K for the year ended December 31, 2008, under Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations*. There have been no changes to these policies during the three and six months ended June 30, 2009.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	38.6	38.6	38.8	38.3
Gross profit	61.4	61.4	61.2	61.7
Operating expenses:				
Marketing and selling	27.5	23.0	28.7	24.9
Research and development	10.6	10.2	10.9	10.3
General and administrative	14.1	13.6	15.3	13.4
Total operating expenses	52.2	46.8	54.9	48.6
Income from operations	9.2	14.6	6.3	13.1
Other income, net	1.0	1.0	0.8	0.5
Income before provision for income tax	10.2	15.6	7.1	13.6
Income tax provision	3.9	6.1	2.7	5.3
Net income	6.3%	9.5%	4.4%	8.3%

Certain reclassifications have been made to the prior period classification of revenue as devices and systems or supplies and services to conform to the current presentation.

We acquired Sonamed in May 2008, Schwarzer Neurology in July 2008 and Neurocom in October 2008. Where significant, we have noted the impact of these acquisitions on our results of operations for the three and six months ended June 30, 2009, as compared to the same periods in 2008.

Three Months Ended June 30, 2009 and 2008

Revenue decreased $2.6 million, or 6.5%, for the three month period ended June 30, 2009 from the comparable 2008 period. The decrease was due primarily to lower capital equipment sales across most of our product lines. We believe that these lower sales resulted from weakness in demand due to the current economic recession and not a loss of market share. Schwarzer Neurology and Neurocom contributed to $3.3 million of revenue offset by a $6.0 million decrease in capital equipment revenue.

Device and systems revenue decreased $3.3 million, or 13.7%, to $20.7 million in the three months ended June 30, 2009 compared to $24.0 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $2.6 million of revenue from devices and systems offset by a $4.8 million decrease in revenue from other neurology products, and a $1.0 million decrease in revenue from hearing products. Revenue from devices and systems was 56% of consolidated revenue in the three months ended June 30, 2009 compared to 60% of consolidated revenue

for the second quarter of 2008.

Supplies and services revenue increased 5%, or $687,000, to $15.8 million in the second quarter of 2009 compared to $15.1 in the same period in 2008. In the 2009 second quarter, revenue from hearing screening and neurology supplies increased by $196,000 and service fees increased by $491,000. Revenue from supplies and services was 42% of consolidated revenue in the three months ended June 30, 2009 compared to 38% of consolidated revenue for the second quarter of 2008.

Table of Contents

Revenue from sales outside the U.S. increased $247,000, or 2.2%, to $11.5 million in the second quarter of 2009 compared to $11.3 million for the same period in 2008. Schwarzer Neurology and Neurocom contributed to $1.9 million of international revenue, offset by $1.2 million decrease in revenue from international systems and devices and an $800,000 decrease in related international supplies and services revenue.

Gross profit as a percentage of revenue was 61.4% for both the three months ended June 30, 2009 and June 30, 2008. The lower margin earned on products of Schwarzer Neurology, which we acquired at the beginning of the third quarter of 2008, was offset by the higher margin earned on balance monitoring products of Neurocom, which we acquired at the beginning of the fourth quarter of 2008. Cost of revenue decreased $1.0 million, or 6.5%, to $14.4 million in the three months ended June 30, 2009, from $15.4 million in 2008, reflecting reduced sales in the 2009 period. Gross profit decreased $1.6 million, or 6.5%, to $22.9 million in 2009, from $24.5 million in 2008.

Total operating costs increased by $783,000 or 4.2%, to $19.5 million in the three months ended June 30, 2009, compared to $18.7 million in the same period in 2008. Schwarzer Neurology and Neurocom, contributed to $1.9 million of operating costs, while other operating costs were approximately 6% lower in the second quarter of 2009 compared to the same period in 2008. The reduction in operating expenses exclusive of Schwarzer Neurology and Neurocom reflect the impact of our 2008 restructuring plan and the implementation of tighter cost controls.

Marketing and selling expenses increased $1.1 million, or 11.7%, to $10.3 million in the three months ended June 30, 2009 compared to $9.2 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $1.2 million of marketing and selling expenses, while other marketing and selling expenses were flat in the second quarter of 2009 compared to the same period in 2008.

Research and development expenses decreased $118,000, or 2.9%, to $4.0 million for in the three months ended June 30, 2009 compared to $4.1 million in the same period of 2008. Schwarzer Neurology and Neurocom contributed to $407,000 of research and development expenses, while other research and development expenses were approximately 13% lower in the second quarter of 2009 compared to the same period in 2008. The reduction in research and development expenses exclusive of Schwarzer Neurology and Neurocom reflect the impact of our 2008 restructuring plan and lower outside service costs.

General and administrative expenses decreased $170,000, or 3.1%, to $5.3 million in the three months ended June 30, 2009 compared to $5.5 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $266,000 of general and administrative expenses, while other general and administrative expenses were approximately 8% lower in the second quarter of 2009 compared to the same period in 2008, reflecting tighter cost controls.

We adopted an integration and restructuring plan in February 2008 that was designed to reduce redundant costs resulting from prior acquisitions and to improve efficiencies in operations. These actions were phased in during the first nine months of 2008. Costs under the plan, which were primarily for severance benefits, stay bonuses, and duplicative salaries, totaled approximately $700,000. Pursuant to the plan, we accrued $141,000 of employee termination benefits in the three months ended June 30, 2008. We had no similar costs in the respective period in 2009.

Other income, net consists of investment income from our investment portfolio, interest expense, net currency exchange gains and losses, and other miscellaneous income and expenses. We reported net other income of $387,000 in the three months ended June 30, 2009, compared to $386,000 in the same period in 2008 due primarily to lower investment income and interest expense and net currency losses in 2009 as compared with higher investment income, higher interest expense and net currency gains in the same period in 2008.

We recorded income tax expense of $1.5 million in the three months ended June 30, 2009, compared to $2.4 million in the same period in 2008. Our effective tax rate in the second quarter of 2009 was 38.7% compared to an effective rate of 39.1% in the second quarter of 2008.

Six Months Ended June 30, 2009

Revenue decreased $6.1 million, or 8.0%, for the six month period ended June 30, 2009 from the comparable 2008 period. The decrease was due primarily to lower capital equipment sales across all of our product lines. We believe that these lower sales resulted from weakness in demand due to the current economic recession and not a loss of market share. Schwarzer Neurology and Neurocom contributed to $6.3 million of revenue offset by a $10.7 million decrease in revenue from our other capital equipment products. Revenue from supplies and services increased by 3.8% to $29.4 million.

Table of Contents

Device and systems revenue decreased $7.1 million, or 15.1%, to $39.8 million in the six months ended June 30, 2009 compared to $46.9 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $4.9 million of revenue from devices and systems offset by a $7.8 million decrease in revenue from other neurology and sleep diagnostics products, a $3.3 million decrease in revenue from hearing products, and a $900,000 decrease in revenue from newborn care and other products. Revenue from devices and systems was 56% of consolidated revenue in the six months ended June 30, 2009 compared to 61% of consolidated revenue for the first half of 2008.

Supplies and services revenue increased $1.1 million, or 3.8%, to $29.4 million in the six months ended June 30, 2009 compared to $28.3 million in the same period in 2008. Schwarzer Neurology and NeuroCom contributed to $1.0 million of revenue from supplies and services. Revenue from supplies and services was 42% of consolidated revenue in the six months ended June 30, 2009 compared to 37% of consolidated revenue for the six months ended June 30, 2008.

Revenue from sales outside the U.S. decreased $1.5 million, or 6.4%, to $21.9 million in the first half of 2009 compared to $23.4 million for the same period in 2008. Schwarzer Neurology and Neurocom contributed to $3.4 million of international revenue. International device and systems revenue decreased $4.6 million and international hearing and newborn care supplies revenue decreased $300,000, reflecting recessionary weakness in international markets.

Gross profit as a percentage of revenue was 61.2% for the six months ended June 30, 2009 compared to 61.7% for the respective period in 2008. The lower margin earned on products of Schwarzer Neurology, which we acquired at the beginning of the third quarter of 2008, and increased materials costs as a percentage of revenue reduced consolidated gross profit for the 2009 period as compared to the same period in 2008. Cost of revenue decreased $2.0 million, or 6.7%, to $27.4 million in the six months ended June 30, 2009, from $29.4 million in 2008, reflecting reduced sales in the 2009 period. Gross profit decreased $4.1 million, or 8.8%, to $43.2 million in 2009 from $47.3 million in 2008.

Total operating costs increased by $1.4 million or 3.8%, to $38.7 million in the six months ended June 30, 2009, compared to $37.2 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $4.0 million of total operating costs, while other operating costs were approximately 7% lower in the first half of 2009 compared to the same period in 2008. The reduction in operating expenses exclusive of Schwarzer Neurology and Neurocom reflect the impact of our 2008 restructuring plan and the implementation of tighter cost controls.

Marketing and selling expenses increased $1.2 million, or 6.2%, to $20.2 million in the six months ended June 30, 2009 compared to $19.1 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $2.5 million of marketing and selling expenses, while other marketing and selling expenses were approximately 7% lower in the six months ended June 30, 2009 compared to the same period in 2008. The reduction in marketing and selling expenses exclusive of Schwarzer Neurology and Neurocom reflect reductions in commission payments to sales personnel and distributors as a result of lower sales, as well as lower travel, promotion, and public relation costs.

Research and development expenses decreased $231,000, or 2.9%, to $7.7 million for in the six months ended June 30, 2009 compared to $7.9 million in the same period of 2008. Schwarzer Neurology and Neurocom contributed to $787,000 of research and development expenses, while other research and development expenses were approximately 13% lower in the six months ended June 30, 2009 compared to the same period in 2008. The reduction in research and development expenses exclusive of Schwarzer Neurology and Neurocom reflect the impact of our 2008 restructuring plan and lower outside service costs.

General and administrative expenses increased $478,000, or 4.6%, to $10.8 million in the six months ended June 30, 2009 compared to $10.3 million in the same period in 2008. Schwarzer Neurology and Neurocom contributed to $714,000 of general and administrative expenses, while other general and administrative expenses were approximately 13% lower in the six months ended June 30, 2009 compared to the same period in 2008, reflecting tighter cost controls.

Pursuant to an integration and restructuring plan adopted in February 2008, we accrued $237,000 of employee termination benefits in the six months ended June 30, 2008. We had no similar costs in the respective period in 2009.

Other income, net consists of investment income from our investment portfolio, interest expense, net currency exchange gains and losses, and other miscellaneous income and expenses. We reported net other income of $513,000 in the six months ended June 30, 2009, compared to $386,000 in the same period in 2008 due primarily to lower interest expense and lower investment income in 2009 compared to the same period in 2008.

We recorded income tax expense of $1.9 million in the six months ended June 30, 2009, compared to $4.1 million in the same period in 2008. Our effective tax rate in the first six months of 2009 was 38.0% compared to an effective rate of 39.0% in the same period in 2008.

Table of Contents

Liquidity and Capital Resources

Liquidity is our ability to generate sufficient cash flows from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate financing or to raise capital. Therefore, liquidity cannot be considered separately from capital resources that consist of our current funds and the potential to increase those funds in the future. We plan to use our capital resources in meeting our commitments and in achieving our business objectives.

As of June 30, 2009, we had cash and cash equivalents of $67.7 million, short-term investments of $866,000, stockholders equity of $232.6 million, and working capital of $110.6 million, compared with cash and cash equivalents of $56.9 million, stockholders equity of $226.5 million, and working capital of $102.3 million as of December 31, 2008.

We believe that our current cash, cash equivalents, and short-term balances, including cash generated from operations, will be sufficient to meet our ongoing operating and capital requirements for the foreseeable future. We completed one acquisition in 2009, three acquisitions in 2008, one in 2007, and three in 2006. We intend to continue to acquire additional technologies, products or businesses, and these acquisitions could be significant. These actions would likely affect our future capital requirements and the adequacy of our available funds. We may be required to raise additional funds through public or private financings, strategic relationships, or other arrangements. Any equity financing may be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants and increase our cost of capital.

On September 2, 2008, we executed a second amendment to our Amended and Restated Credit Agreement (the Second Amendment) with Wells Fargo Bank, National Association (Wells Fargo). The Second Amendment increased the borrowing limit of our revolving line of credit to $25 million and made other changes to the terms of the credit facility. Additional revisions to the credit facility were executed in February 2009 and June 2009. The credit facility contains covenants, including covenants relating to liquidity and other financial measurements, and provides for events of default, including failure to pay any interest when due, failure to perform or observe covenants, bankruptcy or insolvency events and the occurrence of a material adverse effect. We have granted Wells Fargo a security interest in all of our assets.

Cash provided by operations increased by $8.9 million for the six months ended June 30, 2009 to $13.9 million, compared to $5.0 million for the same period in 2008. The sum of our net income and non-cash expense items, such as reserves, depreciation and amortization, and stock based compensation, was approximately $11.3 million in the 2009 period, compared to $10.6 million in 2008. The overall impact of changes in certain operating assets and liabilities on total operating cash flows resulted in a cash inflow of $2.6 million in 2009 compared with a cash outflow of $5.7 million in 2008.

Cash used in investing activities was $4.3 million for the six months ended June 30, 2009 compared to $20.3 million for the same period in 2008. During the six months ended June 30, 2009 we paid $998,000 for acquired businesses and earnout obligations, net of cash acquired, and $866,000 for investment in marketable securities, compared to $6.8 million paid for net business acquisitions and $11.0 million for marketable securities in 2008. We paid $2.1 million for purchases of property and equipment for the six months ended June 30, 2009 compared to $1.8 million in the same period of 2008, and capitalized $377,000 of internal use software development costs in 2009 compared to $738,000 in 2008.

Cash provided by financing activities was $337,000 during the six months ended June 30, 2009, compared to $68.7 million in the same period in 2008. We raised cash through sales of our stock pursuant to our stock awards plans and our employee stock purchase plan in the amount of $414,000 and $1.5 million in the six months ended June 30, 2009 and 2008, respectively. We raised an aggregate of $99.5 million through underwritten public offerings of our common stock in April and May 2008 with no similar transactions in 2009. We also realized an excess tax benefit of $12,000 on the exercise of employee stock options for the six months ended June 30, 2009 that was recorded as an increase to stockholders equity, as compared with a tax benefit of $702,000 in the first six months of 2008. During the six months ended June 30, 2008, we increased our borrowings under our credit facility by $6.0 million and we repaid $23.0 million on our term loan and $16.0 million on our revolving credit facility resulting in a net cash outflow of $33.0 million for the six months ended June 30, 2008, compared with payments of $89,000 for the six months ended June 30, 2009.

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

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

Extent to which we make acquisitions;

Cost and timing of product development efforts and the success of these development efforts;

Table of Contents

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 primarily result from firm, noncancellable purchase orders placed with contract vendors that manufacture some of the components used in our medical devices and related disposable supply products, as well as commitments for leased office, manufacturing, and warehouse facilities. There have been 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, 2008.

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 amounts paid resulting from the indemnification of our directors and officers. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. We believe the estimated fair value of these indemnification agreements is minimal and we have not recorded a liability for these agreements.

Recent Accounting Pronouncements

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

Cautionary Information Regarding Forward Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 about Natus Medical Incorporated. These statements include, among other things, statements concerning our expectations, beliefs, plans, intentions, future operations, financial condition and prospects, and business strategies. The words may, will, continue, estimate, project, intend, believe, expect, anticipate, and other similar expressions generally identify forward-looking statements. Forward-looking statements in this Item 2 include, but are not limited to, statements regarding the following: our effective tax rate for 2009, our expectation that the reduction in capital equipment purchases has stabilized and will not further deteriorate, 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, our expectations with respect to integration of products acquired from Hawaii Medical and our intent to acquire additional technologies, products, or businesses

Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause the actual results predicted in the forward-looking statements as well as our future financial condition and results of operations to differ materially from our historical results or currently anticipated results. Investors should carefully review the information contained under the caption Risk Factors contained in Part II, Item 1A of this report for a description of risks and uncertainties. All forward-looking statements are based on information available to us on the date hereof, and we assume no obligation to update forward-looking statements.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We develop products in the U.S., Canada, and Europe and sell those products primarily in the U.S., Europe and Asia. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Most of our sales in Europe and Asia are denominated in U.S. dollars and Euros, and with the acquisition of Xltek in November 2007, a small portion of our sales are now denominated in Canadian dollars. As our sales in currencies other than the U.S. dollar increase, our exposure to foreign currency fluctuations may increase.

In addition, changes in exchange rates also may affect the end-user prices of our products compared to those of our foreign competitors, who may be selling their products based on local currency pricing. These factors may make our products less competitive in some countries.

Table of Contents

If the U.S. dollar uniformly increased or decreased in strength by 10% relative to the currencies in which our sales were denominated, our net income would have correspondingly increased or decreased by an immaterial amount for the six months ended June 30, 2009. Our interest income is sensitive to changes in the general level of interest rates in the U.S. However, because current market conditions have resulted in historically low rates of return on our investments, a hypothetical decrease 10% in market interest rates would not result in a material decrease in interest income earned on investments held at June 30, 2009.

When able, we invest excess cash in bank money-market funds or discrete short-term investments. The fair value of short-term investments and cash equivalents (investments) is sensitive to changes in the general level of interest rates in the U.S., and the fair value of these investments will fall if market interest rates increase. However, since we generally have the ability to hold these investments to maturity, these declines in fair value may never be realized. If market interest rates were to increase by 10% from levels at June 30, 2009, the fair value of our investments would decline by an immaterial amount.

All of the potential changes noted above are based on sensitivity analyses performed on our financial position as of June 30, 2009. Actual results may differ as our analysis of the effects of changes in interest rates does not account for, among other things, sales of securities prior to maturity and repurchase of replacement securities, the change in mix or quality of the investments in the portfolio, and changes in the relationship between short-term and long-term interest rates.

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, 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 June 30, 2009. Our chief executive officer and chief financial officer determined that as of June 30, 2009 our disclosure controls and procedures were effective for the purpose set forth above.

Changes in Internal Control over Financial Reporting

Under the rules of the Securities and Exchange Commission, internal control over financial reporting is defined as a process designed by, or under the supervision of, an issuer s principal executive and principal financial officers, and effected by the issuer s board of directors, management and other personnel, to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

There was no change in our internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2009, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We may from time to time become a party to various legal proceedings or claims that arise in the ordinary course of business. Our management reviews these matters if and when they arise and believes that the resolution of any of these matters will not have a significant adverse effect on our financial condition.

ITEM 1A. Risk Factors

We have completed a number of acquisitions and expect to complete additional acquisitions in the future. There are numerous risks associated with acquisitions and we may not achieve the expected benefit of any of our acquisitions

Our acquisitions of products, technology assets, or businesses may have a negative impact on our business if we fail to achieve the anticipated financial, strategic, and other benefits of acquisitions or investments, and our operating results may suffer because of this.

Table of Contents

We acquired intellectual property assets and technology patents from Pemstar Pacific Consultants during 2002, Neometrics Inc. and affiliated entities in 2003; Fischer-Zoth in 2004, Bio-logic, Deltamed, and Olympic Medical, and certain assets of Nascor in 2006, Xltek in 2007, Sonamed, Schwarzer Neurology, and Neurocom in 2008, and Hawaii Medical in 2009.

We expect to continue to pursue opportunities to acquire other businesses in future periods. The acquisitions that we have completed may not result in improved operating results for us, or in our achieving a financial condition superior to that which we would have achieved had we not completed them. Our results of operations may be adversely impacted by costs associated with our acquisitions, including one-time charges associated with restructurings or in-process research and development assets. Our acquisitions could fail to produce the benefits that we anticipate, or could have other adverse effects that we currently do not foresee. In addition, some of the assumptions that we have relied upon, such as achievement of operating synergies, may not be realized. In this event, one or more of the acquisitions could result in reduced earnings of Natus as compared to the earnings that would have been achieved by Natus if the acquisition had not occurred.

We have incurred indebtedness to fund some of our acquisitions. The use of debt to fund our acquisitions may have an adverse impact on our liquidity and cause us to place more reliance on cash flow from operations for our liquidity. If our cash flow from operations is not sufficient for our needs, our business could be adversely affected. If we are required to seek additional external financing to support our need for cash to fund future acquisitions, we may not have access to financing on terms that are acceptable to us, or at all. Alternatively, we may feel compelled to access additional financing on terms that are dilutive to existing holders of our common stock or that include covenants that restrict our business, or both. If the recent lack of liquidity in credit markets persists into the future, our ability to obtain debt financing for future acquisitions may be impaired.

If we fail to successfully manage the combined operations of Natus and the businesses we have acquired, we may not realize the potential benefits of the acquisition. Our corporate headquarters are located in San Carlos, California. We also have the following operating divisions: Bio-logic in Illinois, Olympic in Washington, Neurocom in Oregon, Neometrics in New York, Xltek in Ontario, Canada, Deltamed in France, and Fischer-Zoth, IT Med and Schwarzer Neurology in Germany. If we fail to manage these disparate operations effectively, our results of operations could be harmed, employee morale could decline, key employees could leave, and customers could cancel existing orders or choose not to place new ones. In addition, we may not achieve the synergies or other benefits of these and future acquisitions that we anticipate. We may encounter the following additional difficulties, costs, and delays involved in integrating and managing these operations, and the operations of companies we may acquire:

- Failure of customers to continue using the products and services of the combined company;
- Failure to successfully develop the acquired technology into the desired products or enhancements;
- Assumption of unknown liabilities;
- Failure to understand and compete effectively in markets and with products or technologies with which we have limited previous experience;
- Impairment charges incurred to write down the carrying amount of intangible assets, including goodwill, generated as a result of the acquisition;
- Decreased liquidity, restrictive bank covenants, and incremental financing costs associated with debt we may incur to complete future acquisitions; and
- Diversion of the attention of management from other ongoing business concerns.

Our acquisitions of products, technology assets, or businesses may have a negative impact on our business if we fail to achieve the anticipated financial, strategic and other benefits of acquisitions or investments, and our operating results may suffer because of this.

Adverse economic conditions in markets in which we operate may harm our business

Unfavorable changes in U.S. and international economic environments may adversely affect our business and financial results. For example, economic conditions in the countries in which we operate and sell products have recently

Table of Contents

become more negative and global financial markets have experienced volatility and declines since the third quarter of 2008. These conditions stem from slower economic activity, adverse credit conditions, and numerous other factors, and we are unable to foresee when, or if, these factors might return to more normal levels. During challenging economic times, and in tight credit markets, our customers may delay or reduce capital expenditures. These conditions began to adversely affect our operating results in December 2008 and continued to have a significant impact in the first half of 2009 and could continue to result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies, and increased price competition. In addition, these factors have caused us to be more cautious in evaluating potential acquisition opportunities, which could hinder our ability to grow through acquisition while these conditions persist.

Demand for some of our products depends on the capital spending policies of our customers, and changes in these policies could harm our business

A majority of customers for our products are hospitals, physician offices, and clinics. Many factors, including public policy spending provisions, available resources, and economic cycles have a significant effect on the capital spending policies of these entities and the amount that they can spend on our products. If one or more of these factors limit the capital spending of our customers, they will be less likely to purchase new equipment from us or to upgrade to any of our newer equipment products. We believe that the recent lack of liquidity in credit markets, increasing unemployment, and additional effects of the uncertainty in economic conditions worldwide, have had an adverse effect on the spending patterns of our customers and may continue to have such an effect in future periods. This, in turn, can have a significant adverse effect on our operating results and financial position.

Our growth in recent years has depended substantially on the completion of acquisitions and we may not be able to complete acquisitions of this nature or of a relative size in the future to support a similar level of growth

The acquisitions that we have completed have been the primary source of our growth in revenue in recent years. We expend considerable effort in seeking to identify attractive acquisition candidates and, upon doing so, to convince the potential target to consider a sale to us and, ultimately, to negotiate mutually agreeable acquisition terms. If we are not successful in these efforts in the future, our growth rate will not increase at a rate corresponding to that which we have achieved in recent years. Further, as we grow larger it will be necessary to complete the acquisition of larger companies and product lines to support a growth similar to that which we have achieved in the past. The market for attractive acquisitions is competitive and others with greater financial resources than we have may be better positioned than we are to acquire desirable targets. Further, we may not be able to negotiate acquisition terms with target companies that will allow us to achieve positive financial returns from the transaction.

Future changes in technology or market conditions could result in adjustments to our recorded asset balance for intangible assets, including goodwill, resulting in additional charges that could significantly impact our operating results

Our balance sheet includes significant intangible assets, including goodwill and other acquired intangible assets. The determination of related estimated useful lives and whether these assets are impaired involves significant judgments. Our ability to accurately predict future cash flows related to these intangible assets might be hindered by events over which we have no control. Due to the highly competitive nature of the medical device industry, new technologies could impair the value of our intangible assets if they create market conditions that adversely affect the competitiveness of our products. We test our intangible assets, including goodwill, in the fourth quarter of each year, but we may test more frequently if there is a change in circumstances that indicates that the carrying value of these assets may be impaired. Any future determination that these assets are carried at greater than their fair value could result in substantial impairment charges, which could significantly impact our operating results.

Our acquisitions have included in-process research and development assets (IPR&D assets) from which we hope to generate future cash flows; our results of operations could be adversely affected if we are unable to bring these assets to market

Through our acquisitions of other businesses, we have acquired IPR&D assets from which we hope to generate future cash flows. There is inherent risk in bringing these IPR&D assets to market and we may be unable to realize the full value we have assigned to them. We may be unable to complete the development of these IPR&D assets in a timely manner, or we may encounter technological difficulties that prevent us from completing their development. If we are unable to derive future revenue from our IPR&D assets, our results of operations could be adversely impacted.

Table of Contents

We may not be able to preserve the value of our intellectual property because we may not be able to protect access to it or we may lose our intellectual property rights due to expiration of our licenses or patents

If we fail to protect our intellectual property rights or if our intellectual property rights do not adequately cover the technology we employ, other medical device companies could sell products with features similar to ours, and this could reduce demand for our products. We protect our intellectual property through a combination of patent, copyright, trade secret and trademark laws. Despite our efforts to protect our proprietary rights, others may attempt to copy or otherwise improperly obtain and use our products or technology. Policing unauthorized use of our technology is difficult and expensive, and we cannot be certain that the steps we have taken will prevent misappropriation. Our means of protecting our proprietary rights may be inadequate. Enforcing our intellectual property rights could be costly and time consuming and may divert our management s attention and resources. Failing to enforce our intellectual property rights could also result in the loss of those rights.

If health care providers are not adequately reimbursed for procedures conducted with our devices or supplies, or if reimbursement policies change adversely, we may not be successful marketing and selling our products or technologies

Clinicians, hospitals, and government agencies are unlikely to purchase our products if clinicians are not adequately reimbursed for the procedures conducted with our devices or supplies. Unless a sufficient amount of conclusive, peer-reviewed clinical data about our products has been published, third-party payors, including insurance companies and government agencies, may refuse to provide reimbursement. Furthermore, even if reimbursement is provided, it may not be adequate to fully compensate the clinicians or hospitals. Some third-party payors may impose restrictions on the procedures for which they will provide reimbursement. If health care providers cannot obtain sufficient reimbursement from third-party payors for our products or the screenings conducted with our products, we may not achieve significant market acceptance of our products. Acceptance of our products in international markets will depend upon the availability of adequate reimbursement or funding within prevailing health care payment systems. Reimbursement, funding, and health care payment systems vary significantly by country. We may not obtain approvals for reimbursement in a timely manner or at all.

Adverse changes in reimbursement policies in general could harm our business. We are unable to predict changes in the reimbursement methods used by third-party health care payors, particularly those in countries and regions outside the U.S. For example, some payors are moving toward a managed care system in which providers contract to provide comprehensive health care for a fixed cost per person. In a managed care system the cost of our products may not be incorporated into the overall payment for patient care or there may not be adequate reimbursement for our products separate from reimbursement for other procedures.

If we fail in our efforts to educate clinicians, government agency personnel, and third-party payors on the effectiveness of our products, we may not achieve future sales growth

It is critical to the success of our sales efforts that we educate a sufficient number of clinicians, hospital administrators, and government agencies about our products and the costs and benefits of their use. The commercial success of our products depends upon clinician, government agency and other third-party payor confidence in the economic and clinical benefits of our products as well as their comfort with the efficacy, reliability, sensitivity and specificity of our products. We believe that clinicians will not use our products unless they determine, based on published peer-reviewed journal articles and experience, that our products provide an accurate and cost-effective alternative to other means of testing or treatment. Our customers may choose to use competitive products, which may be less expensive or may provide faster results than our devices. Clinicians are traditionally slow to adopt new products, testing practices and clinical treatments, partly because of perceived liability risks and the uncertainty of third-party reimbursement. If clinicians, government agencies and hospital administrators do not adopt our products, we may not maintain profitability. Factors that may adversely affect the medical community s acceptance of our products include:

Publication of clinical study results that demonstrate a lack of efficacy or cost-effectiveness of our products;

Changing governmental and physician group guidelines;

Actual or perceived performance, quality, price, and total cost of ownership deficiencies of our products relative to other competitive products;

Our ability to maintain and enhance our existing relationships and to form new relationships with leading physicians, physician organizations, hospitals, state laboratory personnel, and third-party payors;

Table of Contents

Changes in state and third-party payor reimbursement policies for our products; and

Repeal of laws requiring universal newborn hearing screening and metabolic screening.

Increased sales through group purchasing organizations and sales to high volume purchasers may reduce our average selling prices, which would reduce our revenue and gross profits

We have entered, and expect in the future to enter into agreements with customers who purchase high volumes of our products. Our agreements with these customers may contain discounts from our normal selling prices and other special pricing considerations, which could cause our revenue and profits to decline. In addition, we have entered into agreements to sell our products to members of GPOs, which negotiate volume purchase prices for medical devices and supplies for member hospitals, group practices and other clinics. While we make sales directly to GPO members, the GPO members receive volume discounts from our normal selling price and may receive other special pricing considerations from us. Sales to members of all GPOs accounted for approximately 31%, 35% and 31% of our total revenue during 2008, 2007 and 2006, respectively, and sales to members of one GPO, Novation LLC, accounted for approximately 10%, 9% and 12% of our total revenue in 2008, 2007 and 2006, respectively. Other of our existing customers may be members of GPOs with which we do not have agreements. Our sales efforts through GPOs may conflict with our direct sales efforts to our existing customers. If we enter into agreements with new GPOs and some of our existing customers begin purchasing our products through those GPOs, our revenue and profits could decline.

Our markets are very competitive and in the United States we sell certain of our products in a mature market

We face competition from other companies in all of our product lines. Our competitors range from small, privately-held companies to multinational corporations and their product offerings vary in scope and breadth. We do not believe that any single competitor is dominant in any of our product lines.

The markets for certain of our products in the U.S., including the newborn hearing screening and EEG monitoring markets, are mature and we are unlikely to see significant growth for such products in the U.S. In the U.S. we derive a significant portion of our revenue from the sale of disposable supplies that are used with our hearing screening devices. Because these disposable supply products can generate high margins, we expect that our products, particularly our hearing screening disposable supply products, could face increasing competition, including competitors offering lower prices, which could have an adverse affect on our revenue and margins.

We believe that our primary competitive strengths relate to the functionality and reliability of our products, our recognized brands, and our developed sales channels. Our competitors may have certain competitive advantages, which include the ability to devote greater resources to the development, promotion, and sale of their products. Consequently, we may need to increase our efforts, and related expenses for research and development, marketing, and selling to maintain or improve our position.

We expect recurring sales to our existing customers to generate a majority of our revenue in the future, and if our existing customers do not continue to purchase products from us, our revenue may decline.

Our operating results may decline if we do not succeed in developing, acquiring and marketing additional products or improving our existing products

We intend to develop additional products and technologies, including enhancements of existing products, for the screening, detection, treatment, monitoring and tracking of common medical ailments. Developing new products, and improving our existing products, to meet the needs of current and future customers requires significant investments in research and development. If we fail to successfully sell new products, update our existing products, or timely react to changes in technology, our operating results may decline as our existing products reach the end of their commercial life cycles.

Our plan to expand our international operations will result in increased costs and is subject to numerous risks; if our efforts are not successful, this could harm our business

We have expanded our international operations through acquisitions and plan to expand our international sales and marketing efforts to increase sales of our products in foreign countries. We may not realize corresponding growth in revenue from growth in international unit sales, due to the lower average selling prices we receive on sales outside of the U.S. Even if we are able to successfully expand our international selling efforts, we cannot be certain that we will be able to create or increase demand for our products outside of the U.S. Our international operations are subject to other risks, which include:

Impact of adverse conditions including possible recessions in economies outside the U.S.;

Table of Contents

- Political and economic instability, including instability related to war and terrorist attacks in the U.S. and abroad;
- Contractual provisions governed by foreign law, such as local law rights to sales commissions by terminated distributors;
- Decreased health care spending by foreign governments that would reduce international demand for our products;
- Continued strengthening of the U.S. dollar relative to foreign currencies that could make our products less competitive because most of our international sales are denominated in U.S. dollars;
- Greater difficulty in accounts receivable collection and longer collection periods;
- Difficulties of staffing and managing foreign operations;
- Reduced protection for intellectual property rights in some countries and potentially conflicting intellectual property rights of third parties under the laws of various foreign jurisdictions;
- Difficulty in obtaining and maintaining foreign regulatory approval; and
- Attitudes by clinicians, and cost reimbursement policies, towards use of disposable supplies that are potentially unfavorable to our business.

In particular, our international sales could be adversely affected by a strengthening of the U.S. dollar relative to other foreign currencies, which makes our products more costly to international customers to whom sales are denominated in U.S. dollars.

Our operating results may suffer because of our exposure to foreign currency exchange rate fluctuations

While substantially all of the sales contracts of Natus Medical Incorporated and our North American subsidiaries provide for payment in U.S. dollars, substantially all of the revenue and expenses of our subsidiaries outside of North America are denominated in the local currency. To date we have executed only limited foreign currency contracts to hedge these currency risks. Our future revenue and expenses may be subject to volatility due to exchange rate fluctuations that could result in foreign exchange gains and losses associated with foreign currency transactions and the translation of assets and liabilities denominated in foreign currencies.

Substantially all our sales from our U.S. operations to our international distributors also provide for payment in U.S. dollars. A strengthening of the U.S. dollar relative to other foreign currencies could increase the effective cost of our products to our international distributors as their functional currency is typically not the U.S. dollar. This could have a potential adverse effect on our ability to increase or maintain average selling prices of our products to our foreign-based customers.

If guidelines mandating universal newborn hearing screening do not continue to develop in foreign countries and governments do not mandate testing of all newborns as we anticipate, or if those guidelines have a long phase-in period, our revenue may be adversely impacted

We estimate that approximately 95% of the children born in the U.S. are currently being tested for hearing impairment prior to discharge from the hospital. To date, there has been only limited adoption of newborn hearing screening prior to hospital discharge by foreign governments, and when newborn hearing screening programs are enacted by foreign governments there can be a phase-in period spanning several years. The widespread adoption of guidelines depends, in part, on our ability to educate foreign government agencies, neonatologists, pediatricians, third-party payors, and hospital administrators about the benefits of universal newborn hearing screening as well as the use of our products to perform the screening and monitoring. Our revenue from our newborn hearing screening product lines may not grow if foreign governments do

not require universal newborn hearing screening prior to hospital discharge, if physicians or hospitals are slow to comply with those guidelines, or if governments provide for a lengthy phase-in period for compliance.

Table of Contents

Because we rely on distributors or sub-distributors to sell our products in most of our markets outside of the U.S., our revenue could decline if our existing distributors reduce the volume of purchases from us, or if our relationship with any of these distributors is terminated

We currently rely on our distributors or sub-distributors for a majority of our sales outside the U.S. Some distributors also assist us with regulatory approvals and education of clinicians and government agencies. We intend to continue our efforts to increase our sales in Europe, Japan, and other developed countries. If we fail to sell our products through our international distributors, we would experience a decline in revenues unless we begin to sell our products directly in those markets. We cannot be certain that we will be able to attract new international distributors to market our products effectively or provide timely and cost-effective customer support and service. Even if we are successful in selling our products through new distributors, the rate of growth of our revenue could be harmed if our existing distributors do not continue to sell a large dollar volume of our products. None of our existing distributors are obligated to continue selling our products.

We may be subject to foreign laws governing our relationships with our international distributors. These laws may require us to make payments to our distributors if we terminate our relationship for any reason, including for cause. Some countries require termination payments under local law or legislation that may supersede our contractual relationship with the distributor. Any required payments would adversely affect our operating results.

If we lose our relationship with any supplier of key product components or our relationship with a supplier deteriorates or key components are not available in sufficient quantities, our manufacturing could be delayed and our business could suffer

We contract with third parties for the supply of some of the components used in our products and the production of our disposable products. Some of our suppliers are not obligated to continue to supply us. We have relatively few sources of supply for some of the components used in our products and in some cases we rely entirely on sole-source suppliers. In addition, the lead-time involved in the manufacturing of some of these components can be lengthy and unpredictable. If our suppliers become unwilling or unable to supply us with components meeting our requirements, it might be difficult to establish additional or replacement suppliers in a timely manner, or at all. This would cause our product sales to be disrupted and our revenue and operating results to suffer.

Replacement or alternative sources might not be readily obtainable due to regulatory requirements and other factors applicable to our manufacturing operations. Incorporation of components from a new supplier into our products may require a new or supplemental filing with applicable regulatory authorities and clearance or approval of the filing before we could resume product sales. This process may take a substantial period of time, and we may not be able to obtain the necessary regulatory clearance or approval. This could create supply disruptions that would harm our product sales and operating results.

We depend upon key employees in a competitive market for skilled personnel, and, without additional employees, we cannot grow or maintain profitability

Our products and technologies are complex, and we depend substantially on the continued service of our senior management team. The loss of any of our key employees could adversely affect our business and slow our product development process. Our future success also will depend, in part, on the continued service of our key management personnel, software engineers, and other research and development employees and our ability to identify, hire, and retain additional personnel, including customer service, marketing, and sales staff. Hiring research and development, engineering, sales, marketing and customer service personnel in our industry is very competitive due to the limited number of people available with the necessary technical skills and understanding of our product technologies. We may be unable to attract and retain personnel necessary for the development of our business.

Our ability to market and sell products depends upon receipt of domestic and foreign regulatory approval of our products and manufacturing operations. Our failure to obtain or maintain regulatory approvals and compliance could negatively affect our business

Our products and manufacturing operations are subject to extensive regulation in the United States by the FDA and by similar regulatory agencies in many other countries in which we do business. Our products are classified as medical devices. Medical devices are subject to extensive regulation by the FDA pursuant to regulations that are wide ranging and govern, among other things: design and development; manufacturing and testing; labeling; storage and record keeping; advertising, promotion, marketing, sales distribution and export; and surveillance and reporting of deaths or serious injuries.

Unless an exemption applies, each medical device that we propose to market in the U.S. must first receive one of the following types of FDA premarket review authorizations:

Clearance via Section 510(k) of the Food, Drug, and Cosmetics Act of 1938, as amended; or

Table of Contents

Premarket approval via Section 515 of the Food, Drug, and Cosmetics Act if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA will clear marketing of a medical device through the 510(k) process if it is demonstrated that the new product is substantially equivalent to other 510(k)-cleared products. The premarket approval application process is much more costly, lengthy and uncertain than the 510(k) process, and must be supported by extensive data from preclinical studies and human clinical trials. The FDA may not grant either 510(k) clearance or premarket approval for any product we propose to market. Further, any modification to a 510(k)-cleared device that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design or manufacture, requires a new 510(k) clearance or, possibly, approval of a premarket approval application. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review any manufacturer s decision. If the FDA requires us to seek 510(k) clearance or premarket approval for modification of a previously cleared product for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties. Further, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective.

Delays in receipt or failure to receive clearances or approvals, the loss of previously received clearances or approvals, or the failure to comply with existing or future regulatory requirements could adversely impact our operating results. If the FDA finds that we have failed to comply with these requirements, the Agency can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as:

Fines, injunctions and civil penalties;

Recall or seizure of our products;

Issuance of public notices or warnings;

Imposition of operating restrictions, partial suspension, or total shutdown of production;

Refusal of our requests for Section 510(k) clearance or premarket approval of new products;

Withdrawal of Section 510(k) clearance or premarket approvals already granted; or

Criminal prosecution.

Domestic regulation of our products and manufacturing operations, other than that which is administered by the FDA, includes the Environmental Protection Act, the Occupational Safety and Health Act, and state and local counterparts to these Acts.

Our business would be harmed if the FDA determines that we have failed to comply with applicable regulations governing the manufacture of our products and/or we do not pass an inspection

We and our suppliers are required to demonstrate and maintain compliance with the FDA s Quality System Regulation. The Quality System Regulation sets forth the FDA s requirements for good manufacturing practices of medical devices and includes requirements for, among other things, the design, testing, production processes, controls, quality assurance, labeling, packaging, storage and shipping of such products. In addition, we and our suppliers must engage in extensive recordkeeping and reporting and must make available our manufacturing facility and records for periodic unscheduled inspections by federal, state and foreign agencies, including the FDA. We cannot assure you that we and our suppliers are or will continue to be in full compliance with the Quality System Regulation, and that we will not encounter any manufacturing difficulties.

Failure of our third party suppliers and manufacturers or us to comply with applicable regulations could result in sanctions being imposed on us, including, among other things, fines, injunctions, civil penalties, failure of regulatory authorities to grant marketing approval of our products, delays, suspension or withdrawal of approvals, seizures or recalls of products and manufacturing restrictions, any of which could harm our business.

Our Olympic Cool-Cap product is subject to greater products liability exposure and FDA regulation

The FDA classifies medical devices into one of three classes, depending on the degree of risk associated with each medical device and the extent of controls that are needed to ensure safety and effectiveness. Devices deemed to pose lower risk are placed in either class I or class II. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life supporting or implantable devices, or a device deemed to not be substantially equivalent to a previously cleared 510(k) device are placed in class III, and generally require premarket approval from the FDA before they may be marketed.

Table of Contents

In December 2006 we received premarket approval from the FDA to market the Olympic Cool-Cap, a product designed to lower the cerebral temperature of newborns born with a particular medical condition. This product is a class III minimally invasive medical device, and as such we may be subject to an increased product liability risk relative to our other class I and class II non-invasive products. In addition, this type of product is subject to greater FDA oversight than our other products and there is greater risk that sales of the product could be interrupted due to the premarket approval processes of the FDA and other regulatory bodies.

Our business may suffer if we are required to revise our labeling or promotional materials, or if the FDA takes an enforcement action against us for off-label uses

We are prohibited by the FDA from promoting or advertising our medical device products for uses not within the scope of our clearances or approvals, or from making unsupported promotional claims about the benefits of our products. If the FDA determines that our claims are outside the scope of our clearances, or are unsupported, it could require us to revise our promotional claims or take enforcement action against us. If we were subject to such an action by the FDA, our sales could be delayed, our revenue could decline, and our reputation among clinicians could be harmed. Likewise, if we acquire new products, either through the purchase of products, technology assets, or businesses, that are subsequently deemed to have inadequate supporting data, we may be required to (i) obtain adequate data, which could be costly and impede our ability to market these products, or (ii) modify the labeling on these products, which could impair their marketability, as described above.

If we fail to comply with healthcare regulations, we could face substantial penalties and our business, operations and financial condition could be adversely affected.

We do not provide healthcare services, control the referral of patients for healthcare services, nor bill Medicare, Medicaid or other third-party payors; however, due to the breadth of many healthcare laws and regulations, we could be subject to healthcare fraud regulation and enforcement by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include: (i) the federal healthcare programs Anti-Kickback Law, which prohibits, among other things, persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual for, or the purchase, order or recommendation of, any good or service for which payment may be made under federal healthcare programs such as Medicare or Medicaid, (ii) federal false claims laws which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payors that are false or fraudulent, and which may apply to entities like us which provide coding and billing advice to customers, and/or (iii) state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers, many of which differ from their federal counterparts in significant ways, thus complicating compliance efforts.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations. Any penalties, damages, fines, curtailment or restructuring of our operations could adversely affect our ability to operate our business and our financial results. The risk of our being found in violation of these laws is increased by the fact that their provisions are open to a variety of interpretations. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management s attention from the operation of our business.

Our operating results would suffer if we were subject to a protracted infringement claim

The medical technology industry is characterized by a substantial amount of litigation and related administrative proceedings regarding patents and intellectual property rights. We expect that medical screening and diagnostic products may become increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlap. Third parties such as individuals, educational institutions or other medical device companies may claim that we infringe their intellectual property rights. Any claims, with or without merit, could have any of the following negative consequences:

Result in costly litigation and damage awards;

Divert our management s attention and resources;

Table of Contents

Cause product shipment delays or suspensions; or

Require us to seek to enter into royalty or licensing agreements.

A successful claim of infringement against us could result in a substantial damage award and materially harm our financial condition. Our failure or inability to license the infringed or similar technology, or design and build non-infringing products, could prevent us from selling our products and adversely affect our business and financial results.

We license intellectual property rights from third parties and would be adversely affected if our licensors do not appropriately defend their proprietary rights or if we breach any of the agreements under which we license commercialization rights to products or technology from others

We license rights from third parties for products and technology that are important to our business. If our licensors are unsuccessful in asserting and defending their proprietary rights, including patent rights and trade secrets, we may lose the competitive advantages we have through selling products that we license from third parties. Additionally, if it is found that our licensors infringe on the proprietary rights of others, we may be prohibited from marketing our existing products that incorporate those proprietary rights. Under our licenses, we are subject to commercialization and development, sublicensing, royalty, insurance and other obligations. If we fail to comply with any of these requirements, or otherwise breach a license agreement, the licensor may have the right to terminate the license in whole or to terminate the exclusive nature of the license.

Product liability suits against us could result in expensive and time consuming litigation, payment of substantial damages, and an increase in our insurance rates

The sale and use of our products could lead to the filing of a product liability claim by someone claiming to have been injured using one of our products or claiming that one of our products failed to perform properly. A product liability claim could result in substantial damages and be costly and time consuming to defend, either of which could materially harm our business reputation or financial condition. Our product liability insurance may not protect our assets from the financial impact of defending a product liability claim. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing any coverage in the future.

We have experienced seasonality in the sale of our products

We experience seasonality in our revenue. For example, our sales typically decline from our fourth fiscal quarter to our first fiscal quarter, due to patterns in the capital budgeting and purchasing cycles of our current and prospective customers, many of which are government agencies. We may also experience declining sales in the third fiscal quarter due to summer holiday and vacation schedules. We anticipate that we will continue to experience these seasonal fluctuations, which may lead to fluctuations in our quarterly operating results. We believe that you should not rely on our results of operations for interim periods as an indication of our expected results in any future period.

We have initiated changes to our information systems that could disrupt our business and our financial results.

We plan to continuously improve our enterprise resource planning, customer relationship management, and document lifecycle management systems to support the form, functionality, and scale of our business. These types of transitions frequently prove disruptive to the underlying business of an enterprise and may cause us to incur higher costs than we anticipate. Failure to manage a smooth transition to the new systems and the ongoing operations and support of the new systems could materially harm our business operations.

For example, we are currently in the process of implementing the rollout of an enterprise resource planning application (ERP) in our North American operating divisions. Until we have completed the ERP implementation, we will be dependent on multiple platforms. We may experience difficulties in implementing the ERP and we may fail to gain the efficiencies the implementation is designed to produce. The implementation could also be disruptive to our operations, including the ability to timely ship and track product orders to customers, project inventory requirements, manage our supply chain and otherwise adequately service our customers**.**

Table of Contents

ITEM 4. Submission of Matters to a Vote of Security Holders

We held our Annual Meeting of Stockholders on June 16, 2009. We solicited votes by proxy pursuant to proxy solicitation materials distributed to stockholders on or about May 7, 2009. The following is a brief description of the matters voted on at the meeting and a statement of the number of votes cast for, against or withheld and the number of abstentions:

1. Election of Doris Engibous and William Moore as directors until the Annual Meeting of Stockholders in 2012 or until their successors are elected.

Nominee	In Favor	Withheld
Doris Engibous	20,497,810	4,401,980
William M. Moore	20,334,525	4,565,265

Our other continuing directors include Robert A. Gunst, James B. Hawkins, Ken Ludlum and Mark D. Michael.

2. The ratification of the appointment of Deloitte & Touche LLP, an independent registered public accounting firm, as our auditors for the year ending December 31, 2009:

For	Against	Abstain
24,684,216	106,683	108,891

ITEM 6. Exhibits

(a) Exhibits

		Incorporated By Reference			
Exhibit No.	**Exhibit**	**Filing**	**Exhibit No.**	**File No.**	**File Date**
10.1	Fourth Amendment to Amended and Restated Credit Agreement between Natus Medical Incorporated and Wells Fargo Bank National Association				
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				

Table of Contents

SIGNATURES

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

NATUS MEDICAL INCORPORATED

Dated: August 7, 2009 By: /s/ James B. Hawkins
James B. Hawkins

President and Chief Executive Officer

(Principal Executive Officer)

Dated: August 7, 2009 By: /s/ Steven J. Murphy
Steven J. Murphy

Vice President Finance and

Chief Financial Officer

(Principal Financial and Accounting Officer)

Table of Contents

NATUS MEDICAL INCORPORATED

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