Alphatec Holdings, Inc.
Form 10-Q
August 07, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

¨ **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: 000-52024

ALPHATEC HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2463898**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

5818 El Camino Real

Carlsbad, CA 92008

(Address of principal executive offices, including zip code)

(760) 431-9286

(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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a small 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 As of August 5, 2013, there were 97,098,085 shares of the registrant s common stock outstanding.

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ALPHATEC HOLDINGS, INC.

QUARTERLY REPORT ON FORM 10-Q

June 30, 2013

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(In thousands, except for par value data)

	June 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 12,948	$ 22,241
Accounts receivable, net	41,031	41,012
Inventories, net	50,614	49,855
Prepaid expenses and other current assets	5,619	5,953
Deferred income tax assets	2,835	2,991
Total current assets	113,047	122,052
Property and equipment, net	30,471	30,403
Goodwill	177,832	180,838
Intangibles, net	43,611	46,856
Other assets	1,710	1,978
Total assets	$ 366,671	$ 382,127
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 18,329	$ 15,237
Accrued expenses	29,597	38,490
Deferred revenue	1,176	1,361
Current portion of long-term debt	709	1,700
Total current liabilities	49,811	56,788
Long-term debt, less current portion	41,118	39,967
Other long-term liabilities	11,988	13,485
Deferred income tax liabilities	2,269	2,468
Redeemable preferred stock, $0.0001 par value; 20,000 authorized at June 30, 2013 and December 31, 2012; 3,319 shares issued and outstanding at both June 30, 2013 and December 31, 2012	23,603	23,603
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.0001 par value; 200,000 authorized at June 30, 2013 and December 31, 2012; 97,098 and 96,703 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	10	10
Treasury stock, 19 shares	(97)	(97)
Additional paid-in capital	401,389	399,246
Accumulated other comprehensive (loss) income	(2,655)	112
Accumulated deficit	(160,765)	(153,455)

Total stockholders equity	237,882	245,816
Total liabilities and stockholders equity	$ 366,671	$ 382,127

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	$ 51,020	$ 48,235	$ 101,463	$ 96,696
Cost of revenues	18,501	17,666	35,771	33,929
Amortization of acquired intangible assets	426	373	857	752
Gross profit	32,093	30,196	64,835	62,015
Operating expenses:				
Research and development	3,666	3,777	7,348	7,787
Sales and marketing	19,160	19,529	37,655	38,065
General and administrative	11,445	10,132	22,575	18,957
Amortization of acquired intangible assets	721	509	1,514	1,083
Total operating expenses	34,992	33,947	69,092	65,892
Operating loss	(2,899)	(3,751)	(4,257)	(3,877)
Other income (expense):				
Interest income		36	2	75
Interest expense	(927)	(3,578)	(1,622)	(4,286)
Other income (expense), net	(400)	(9)	(1,050)	(268)
Total other income (expense)	(1,327)	(3,551)	(2,670)	(4,479)
Loss from continuing operations before taxes	(4,226)	(7,302)	(6,927)	(8,356)
Income tax provision (benefit)	435	(928)	383	(721)
Net loss	$ (4,661)	$ (6,374)	$ (7,310)	$ (7,635)
Net loss per common share:				
Basic and diluted net loss per share	$ (0.05)	$ (0.07)	$ (0.08)	$ (0.09)
Weighted-average shares used in computing net loss per share:				
Basic and diluted	95,926	89,218	95,876	89,078

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(UNAUDITED)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net loss	$ (4,661)	$ (6,374)	$ (7,310)	$ (7,635)
Foreign currency translation adjustments	1,718	(8,566)	(2,767)	(4,320)
Comprehensive loss	$ (2,943)	$ (14,940)	$ (10,077)	$ (11,955)

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Operating activities:		
Net loss	$ (7,310)	$ (7,635)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	12,589	11,623
Stock-based compensation	1,979	1,210
Interest expense related to amortization of debt discount and debt issuance costs	209	771
Provision for doubtful accounts	184	928
Provision for excess and obsolete inventory	3,101	2,810
Deferred income tax benefit	(156)	(2,006)
Other noncash items	1,065	1,098
Changes in operating assets and liabilities:		
Accounts receivable	(1,310)	1,635
Inventories	(5,079)	(3,927)
Prepaid expenses and other current assets	547	1,146
Other assets	102	551
Accounts payable	2,170	(3,349)
Accrued expenses and other	(5,430)	(1,164)
Deferred revenues	(179)	(117)
Net cash provided by operating activities	2,482	3,574
Investing activities:		
Purchases of property and equipment	(7,681)	(7,998)
Purchase of intangible assets	(500)	(650)
Cash paid for acquisitions	(4,000)	
Net cash used in investing activities	(12,181)	(8,648)
Financing activities:		
Exercise of stock options		16
Borrowings under lines of credit	68,746	47,143
Repayments under lines of credit	(66,926)	(29,956)
Principal payments on notes payable and capital lease obligations	(1,432)	(11,470)
Net cash provided by financing activities	388	5,733
Effect of exchange rate changes on cash and cash equivalents	18	698
Net increase (decrease) in cash and cash equivalents	(9,293)	1,357
Cash and cash equivalents at beginning of period	22,241	20,666
Cash and cash equivalents at end of period	$ 12,948	$ 22,023

	Six Months Ended June 30, 2013	2012
Supplemental cash flow information:		
Cash paid for interest	$ 1,786	$ 1,107
Cash paid for income taxes	$ 1,226	$ 423
Purchases of property and equipment in accounts payable	$ 2,274	$ 3,151
Property and equipment purchased under capital lease	$	$ 1,149

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. The Company and Basis of Presentation

The Company

Alphatec Holdings, Inc. (Alphatec , Alphatec Holdings or the Company), through its wholly owned subsidiary, Alphatec Spine, Inc. and its subsidiaries (Alphatec Spine) designs, develops, manufactures and markets products for the surgical treatment of spine disorders, primarily focused on the aging spine. In addition to its U.S. operations, the Company also markets its products in over 50 international markets through its affiliate, Scient x S.A.S. and its subsidiaries (Scient x), via a direct sales force in France, Italy and the United Kingdom and via independent distributors in the rest of Europe, the Middle East and Africa. In South America and Latin America, the Company conducts its operations through its Brazilian subsidiary, Cibramed Productos Medicos. In Asia, the Company markets its products through its subsidiary, Alphatec Pacific, Inc. and its subsidiaries (Alphatec Pacific) via a direct sales force and independent distributors, and through distributors in other parts of Asia and Australia.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of December 31, 2012, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with U.S. generally accepted accounting principles (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) related to a quarterly report on Form 10-Q. Certain information and note disclosures normally included in annual audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made in this quarterly report on Form 10-Q are adequate to make the information not misleading. The interim unaudited condensed consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations for the periods presented. All such adjustments are of a normal and recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited financial statements for the year ended December 31, 2012, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012 that was filed with the SEC on March 4, 2013.

Operating results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013, or any other future periods.

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. A going concern basis of accounting contemplates the recovery of the Company s assets and the satisfaction of its liabilities in the normal course of business. Based on the Company s annual operating plan, management believes that its existing cash and cash equivalents of $12.9 million combined with anticipated cash flow from operations in 2013 and other working capital of $50.3 million at June 30, 2013 will be sufficient to fund its cash requirements through at least June 30, 2014. The Company s credit facility (the Credit Facility) with MidCap Financial, LLC (MidCap) contains financial covenants consisting of a monthly fixed charge coverage ratio and a senior leverage ratio (see Note 6).

Based on the Company s board-approved current operating plan, the Company believes that it will be in compliance with the financial covenants of the Credit Facility at least through June 30, 2014. However, there is no assurance that the Company will be able to do so. If the Company is not able to achieve its planned revenue or incurs costs in excess of its forecasts, it may be required to substantially reduce discretionary spending and it could be in default of the Credit Facility which would require a waiver from MidCap. There can be no assurance that such a waiver could be obtained, that the Credit Facility could be successfully renegotiated or that the Company could modify its operations to maintain liquidity. If the Company is unable to obtain any required waivers or amendments, MidCap would have the right to exercise remedies specified in the Credit Facility, including accelerating the repayment of debt obligations. The Company may be forced to seek additional financing, such as additional debt and/or equity financing or funding through other third party agreements. There can be no assurances that additional financing would be available on acceptable terms or available at all. Furthermore, any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.

2. Summary of Significant Accounting Policies

The Company s significant accounting policies are described in Note 2 to its audited consolidated financial statements for the year ended December 31, 2012, which are included in the Company s Annual Report on Form 10-K that was filed with the SEC on March 4, 2013. These accounting policies have not significantly changed during the six months ended June 30, 2013.

Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board (FASB) issued guidance on a parent company s accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendments will be effective for the Company beginning January 1, 2014. We do not anticipate any impact on our financial statements upon adoption.

In February 2013, the FASB issued guidance that requires a company to disaggregate the total change of each component of other comprehensive income either on the face of the income statement or as a separate disclosure in the notes. The new guidance became effective for the Company s interim period ended March 31, 2013. The Company adopted this guidance and the adoption did not have any impact on its financial position, results of operations or cash flows.

3. Acquisitions

Acquisition of Phygen, LLC

On November 6, 2012, the Company closed the transactions contemplated by the Asset Purchase Agreement (the Asset Purchase Agreement) with Phygen, LLC (Phygen), pursuant to which the Company agreed to purchase Phygen s right, title and interest in and certain assets used by Phygen in connection with the design, development, marketing and distribution of certain of Phygen s spinal implant products, together with the intellectual property rights, contractual rights, inventories and certain liabilities related thereto. At the closing of the transaction the Company issued to Phygen 4,069,087 unregistered shares of the Company s common stock and paid to Phygen $2 million in cash. The Company placed 1,170,960 unregistered shares of the common stock into an escrow account, which will serve as security against any potential indemnification obligations of Phygen under the Asset Purchase Agreement for a period of 12 months following the closing. In addition, pursuant to the Asset Purchase Agreement, the Company paid to Phygen $4 million in cash in April 2013.

Based on the closing price of Alphatec s common stock of $1.69 on November 6, 2012, cash consideration and contingent liabilities, the total purchase price for Phygen was as follows (in thousands):

Fair value of Alphatec common stock issued upon closing	$ 8,856
Cash consideration paid and payable	5,900
Contingent consideration	3,724
Total purchase price	$ 18,480

Under the acquisition method of accounting, the total purchase price allocated to Phygen s net tangible and intangible assets was based on their estimated fair values at the date of the completion of the acquisition.

The following table summarizes the allocation of the purchase price Phygen and the estimated useful lives for the acquired intangible assets (in thousands):

	Useful lives (in years)	Estimated Fair Value
Net tangible assets assumed		$ 1,086
Acquired intangibles:		
Developed technology	3	176
Trademarks	3	59
Covenant not-to-compete	3	389
Customer-related intangibles	12	5,843
Distribution network	12	2,413
Goodwill		8,514
Total purchase price allocation		$ 18,480

The Company allocated $1.1 million to Phygen s net tangible assets assumed, $8.9 million to identifiable intangible assets acquired and $3.7 million to contingent consideration. A value of $8.5 million, representing the difference between the total purchase price and the aggregate fair values assigned to the net tangible and intangible assets acquired, less liabilities and contingent consideration assumed, was assigned to goodwill. The Company acquired Phygen to expand its product offerings to Phygen s existing surgeon base. This and other factors contributed to a purchase price for Phygen that resulted in the recognition of goodwill. The amount recorded as acquired intangibles and goodwill is expected to be deductible for tax purposes.

The Company increased the value of inventory it acquired from Phygen to its estimated fair value (inventory step-up), which represented an amount equivalent to estimated selling prices for the inventory less distribution related costs and a normative selling profit. Consistent with stock rotation, the inventory step-up was reversed ratably over six months and is included in the Company s post-combination financial statements.

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For the technology-related assets, the Company determined the values for each of these categories by estimating the present values of the net cash flows expected to be generated by each category of technology.

The Company calculated the value of the trademark by estimating the present value of future royalty costs that would be avoided by a market participant due to ownership of the trademarks acquired.

The Company calculated the value of the covenant not-to-compete by estimating the difference between the present value of future cash flows with and without the covenant not-to-compete in place.

The customer-related intangibles include hospitals and distributors that take title to Phygen s products. The Company determined the value of such customer-related intangibles by estimating the present value of expected future net cash flows derived from such customers.

The distribution network includes U.S.-based distributors that provide Phygen s products to customers on a consignment basis. The Company determined the value of the intangibles related to the distribution network by estimating the difference between the present values of expected future net cash flows generated with and without the distribution network in place.

The Company calculated the value of the contingent consideration by estimating the present value of future minimum royalty payments due under licensing agreements entered into in connection with the Phygen acquisition. The Company will revalue the contingent consideration each reporting period with an offset to any increase or decrease in the statement of operations. This is a Level 3 measurement as significant assumptions used in the measurement include estimates of the royalty payments due.

Pro forma supplemental financial information is not provided as the impact of the Phygen acquisition was not material to operating results in the three and six months ended June 30, 2012.

4. Select Balance Sheet Details

Accounts Receivable, net

Accounts receivable, net consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Accounts receivable	$ 42,092	$ 42,086
Allowance for doubtful accounts	(1,061)	(1,074)
Accounts receivables, net	$ 41,031	$ 41,012

Inventories, net

Inventories, net consist of the following (in thousands):

	June 30, 2013			December 31, 2012		
	Gross	Reserve for excess and obsolete	Net	Gross	Reserve for excess and obsolete	Net
Raw materials	$ 5,746	$	$ 5,746	$ 5,863	$	$ 5,863
Work-in-process	859		859	1,350		1,350
Finished goods	61,659	(17,650)	44,009	59,864	(17,222)	42,642
Inventories, net	$ 68,264	$ (17,650)	$ 50,614	$ 67,077	$ (17,222)	$ 49,855

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Property and Equipment, net

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

	Useful lives (in years)	June 30, 2013	December 31, 2012
Surgical instruments	4	$ 61,131	$ 56,712
Machinery and equipment	7	14,594	13,996
Computer equipment	5	3,310	3,269
Office furniture and equipment	5	3,696	3,528
Leasehold improvements	various	4,109	4,092
Building	39	56	64
Land	n/a	11	13
Construction in progress	n/a	302	1,045
		87,209	82,719
Less accumulated depreciation and amortization		(56,738)	(52,316)
Property and equipment, net		$ 30,471	$ 30,403

Total depreciation expense was $3.7 million and $3.5 million for the three months ended June 30, 2013 and 2012, respectively. Total depreciation expense was $7.2 million and $7.0 million for the six months ended June 30, 2013 and 2012, respectively.

Intangible Assets, net

Intangible assets, net consist of the following (in thousands except as indicated):

	Useful lives (in years)	June 30, 2013	December 31, 2012
Developed product technology	3-8	$ 23,136	$ 23,253
Distribution rights	3	3,967	4,281
Intellectual property	5	1,004	1,004
License agreements	1-7	17,436	17,423
Core technology	10	4,875	4,940
Trademarks and trade names	3-9	3,757	3,796
Customer-related	12-15	21,411	19,221
Distribution network	10-12	4,027	3,906
Physician education programs	10	2,999	3,039
Supply agreement	10	225	225
		82,837	81,088
Less accumulated amortization		(39,226)	(34,232)
Intangible assets, net		$ 43,611	$ 46,856

Total amortization expense was $2.7 million and $2.3 million for the three months ended June 30, 2013 and 2012, respectively. Total amortization expense was $5.4 million and $4.6 million for the six months ended June 30, 2013 and 2012, respectively.

Goodwill

The changes in the carrying amount of goodwill from December 31, 2012 through June 30, 2013 are as follows (in thousands):

	2013
Balance at December 31, 2012	$ 180,838
Change in Phygen goodwill	(1,610)
Effect of foreign exchange rate on goodwill	(1,396)
Balance at June 30, 2013	$ 177,832

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5. License and Supply Agreements

The Company s license and developmental consulting agreements are described in Note 5 to its audited consolidated financial statements for the year ended December 31, 2012, which are included in its Annual Report on Form 10-K which was filed with the SEC on March 4, 2013.

6. Debt

Loan and Security Agreement

On June 7, 2012, the Company entered into the Credit Facility with MidCap, which permits the Company to borrow up to $50 million. The Credit Facility is due in June 2015 and consists of a revolving line of credit with a maximum borrowing base of $40 million, with the option to increase the maximum borrowing base to $50 million with the prior written consent of MidCap. The borrowing base is determined, from time to time, based on the value of domestic and foreign eligible accounts receivable and domestic eligible inventory. As collateral for the Credit Facility, the Company granted MidCap a security interest in substantially all of its assets, including all accounts receivable and all securities evidencing its interests in its subsidiaries. The revolving line of credit carries an interest rate equal to the London Interbank Offered Rate (LIBOR) plus 6.0%, which was 6.2% at June 30, 2013.

Upon execution of the Credit Facility, the Company drew $34.3 million on the Credit Facility to pay off its existing term loan with Silicon Valley Bank (SVB) totaling $8.1 million and its existing line of credit with SVB totaling $17.6 million (collectively the SVB Credit Facility). The Company paid early termination and other fees to SVB associated with the SVB Credit Facility of $2.3 million and wrote-off $0.6 million of unamortized debt issuance and debt discount costs related to the SVB Credit Facility. The total loss on extinguishment of debt costs of $2.9 million is included in interest expense in the three and six months ended June 30, 2012. The Company paid an up-front commitment fee to MidCap of $0.2 million and debt issuance costs of $0.2 million, which were capitalized as deferred debt issuance costs and are being amortized over the term of the Credit Facility using the effective interest method.

The Credit Facility includes traditional lending and reporting covenants including a fixed charge coverage ratio and a senior leverage ratio to be maintained by the Company. The Credit Facility also includes several potential events of default, such as payment default and insolvency conditions, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap s right to declare all outstanding obligations immediately due and payable. In January 2013, the Company entered into a limited waiver and limited consent agreement with MidCap (the Waiver). Under the Waiver, MidCap gave the Company its consent to waive certain provisions of the Credit Facility in connection with the acquisition of Phygen and related to the maintenance of cash balances in the U.S. In February 2013, the Company and MidCap entered into a first amendment to the Credit Facility (the First Amendment). The First Amendment allows the Company to exclude payments related to the Phygen acquisition and the settlement agreement with Cross Medical Products, LLC (Cross) from calculation of the fixed charge coverage ratio and the senior leverage ratio. In conjunction with the First Amendment, the Company paid MidCap a fee of $0.1 million. In July 2013, the Company entered into a second limited waiver and limited consent agreement with MidCap (the Second Waiver). Under the Second Waiver, MidCap gave the Company its consent to waive certain provisions of the Credit Facility related to the maintenance of cash balances in the U.S. for past periods through September 30, 2013. The Company was in compliance with all of the covenants of the Credit Facility as of June 30, 2013.

Principal payments on debt are as follows as of June 30, 2013 (in thousands):

Year Ending December 31,	
Remainder of 2013	$ 287
2014	
2015	40,000
2016	
2017	
Thereafter	
Total	40,287
Add: capital lease principal payments	1,540
Total	41,827
Less: current portion of long-term debt	(709)

Long-term debt, net of current portion	$ 41,118

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7. Commitments and Contingencies

Leases

The Company leases certain equipment under capital leases which expire on various dates through June 2017. The leases bear interest at rates ranging from 6.6% to 9.6%, are generally due in monthly principal and interest installments and are collateralized by the related equipment. The Company also leases its buildings and certain equipment and vehicles under operating leases which expire on various dates through 2017. Future minimum annual lease payments under such leases are as follows (in thousands):

Year Ending December 31,	Operating	Capital
Remainder of 2013	$ 1,990	$ 264
2014	3,199	527
2015	2,632	466
2016	1,385	423
2017	211	81
Thereafter	15	
	$ 9,432	1,761

Less: amount representing