NATUS MEDICAL INC
Form 10-K
March 15, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2009**

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 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 Number)**

1501 Industrial Road, San Carlos, California 94070

(Address of principal executive offices, including zip code)

(650) 802 0400

(Registrant s telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

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

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer 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 Act). Yes ¨ No x

As of June 30, 2009, the last business day of Registrant s most recently completed second fiscal quarter, there were 28,323,029 shares of Registrant s common stock outstanding, and the aggregate market value of such shares held by non-affiliates of Registrant (based upon the closing sale price of such shares on the Nasdaq Global Select Market on June 30, 2009) was $260,973,950. Shares of Registrant s common stock held by each executive officer and director and by each entity that owns 5% or more of Registrant s outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On March 8, 2010, the registrant had 28,417,196 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant has incorporated by reference, into Part III of this Form 10-K, portions of its Proxy Statement for the 2010 Annual Meeting of Stockholders.

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NATUS MEDICAL INCORPORATED

ANNUAL REPORT ON FORM 10-K

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PART I

ITEM 1. Business

This Annual Report on Form 10-K 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 (Natus, we, us, or our Company). 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 1 include, but are not limited to, statements regarding the effectiveness and advantages of our products, factors relating to demand for and economic advantages of our products, our plan to develop and acquire additional technologies, products or businesses, our marketing, technology enhancement, and product development strategies, and our ability to complete all of our backlog orders.

Forward-looking statements are not guarantees of future performance and are subject to substantial risks and uncertainties that could cause the actual results to differ materially from those that we predicted in the forward-looking statements. Investors should carefully review the information contained under the caption Risk Factors contained in Item 1A for a description of risks and uncertainties that could cause actual results to differ from those that we predicted. 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.

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®, Gumdrop®, Keypoint®, Keypoint AU®, Keypoint EU®, and Keypoint JP®, MASTER®, Navigator®, Neatnick®, neoBLUE®, Neuromax®, NeuroWorks®, Oxydome®, Sleeprite®, Sleepscan®, Smart Scale®, Tootsweet®, Traveler®, Warmette® and VAC-PAC® are registered trademarks of Natus Medical Incorporated and its subsidiaries. Accuscreen , Bili-Lite Pad , Bili-Lite , Biomark , Circumstraint , Coherence , Deltamed , inVision , MiniMuffs , Neometrics Smartpack are non-registered trademarks of Natus and its subsidiaries. Solutions for Newborn Care℠ is a non-registered service mark of Natus.

Overview

Natus is a leading provider of healthcare products used for the screening, detection, treatment, monitoring and tracking of common medical ailments in newborn care, hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and balance and mobility disorders. Product offerings include computerized neurodiagnostic systems for audiology, neurology, polysomnography, and neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, 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. Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008; and Hawaii Medical and Alpine Biomed in 2009.

Product Families

We categorize our products into the following product families:

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

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Monitoring Systems for Neurology Includes products for diagnostic electroencephalography (EEG), diagnostic sleep analysis, or polysomnography (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.

Our principal product offerings within these product families are presented in the table on the following page.

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Our Product Offerings

Hearing

Newborn Hearing Screening

Overview

Hearing impairment is the most common treatable chronic disorder in newborns, affecting as many as five babies out of every 1,000 newborns. It is estimated that 20,000 hearing-impaired babies are born in the United States (U.S.) every year, and as many as 60,000 more in the rest of the developed world. Until the introduction of universal newborn hearing screening programs, screening was generally performed only on those newborns that had identifiable risk factors for hearing impairment. However, screening only those newborns with risk factors for hearing impairment overlooks approximately half of newborns with some level of hearing impairment.

Early identification of hearing impairment and early intervention has been shown to improve language development significantly. Undetected hearing impairment often results in the failure to learn, process spoken language, and speak. If hearing impairment is not detected prior to discharge from the hospital it is often not detected until the child is 18 months of age or older. A 1997 study conducted at the University of Colorado, Boulder evaluated the impact of hearing impairment on language and speech. All of the children evaluated in the study were born with a hearing impairment but differed by the age at which the hearing impairment was detected. The study concluded that those children whose hearing loss was detected early and who received appropriate treatment had significantly better language skills and vocabularies than those children whose hearing loss was detected later.

Newborn Hearing Screening in the United States

We estimate that today approximately 95% of the children born in the U.S. are being screened for hearing impairment prior to discharge from the hospital. In 1994, the American Academy of Pediatrics Task Force on Newborn and Infant Hearing first published specific guidelines for universal newborn hearing screening programs. In 2000 and 2007, the Joint Committee on Infant Hearing (JCIH) Position Statements outlined principles, guidelines, and benchmarks for early hearing detection and intervention programs. These principles and guidelines are considered the standard of care today. Because positive results are referred to an audiologist or an Ear, Nose and Throat physician (ENT) for additional testing and evaluation, limiting the number of refers stemming from false positive results reduces the cost of a newborn screening program. In addition, false positive results can cause unnecessary emotional distress for parents.

The 2007 JCIH Position Statement updated and expanded the definition of targeted hearing loss and recommended a specific protocol for babies admitted to the Neonatal Intensive Care Unit (NICU) for more than 5 days. Additionally, the document expressed increased awareness, not only of the need for diagnostic audiology evaluation for children diagnosed with hearing impairment at birth, but also for surveillance and hearing screening for children at risk of delayed onset and progressive hearing impairment during the first three years of life.

Newborn Hearing Screening Techniques

The two traditional technologies used to screen newborns and infants for hearing impairment are auditory brainstem response and OAE s.

Auditory brainstem response (ABR). ABR technology is the most accurate and comprehensive method for screening and diagnosing hearing impairment. ABR technology is based on detecting the brain s electric impulses resulting from a specific auditory stimulus. ABR screening devices, used for newborn hearing screening, detect and analyze the brainwave response resulting from audible click stimuli presented to the

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infant s ears. Automated Auditory Brainstem Response (AABR) devices were developed to automatically analyze the ABR waveform resulting from the auditory stimuli with computerized detection algorithms and statistical analysis. These devices can be used by any level of hospital personnel with a minimal amount of training and will deliver a clinically valid and accurate screen. The detection algorithms indicate a PASS or REFER result that requires no interpretation, thereby reducing staffing requirements, test times, and total hearing screening program costs. A REFER test result indicates that the patient should be referred to an Audiologist or ENT for further diagnostic evaluation.

Otoacoustic emission (OAE). OAEs are sounds created by the active biomechanical processes within the sensory cells of the cochlea. They occur both spontaneously and in response to acoustic stimuli. OAE screening uses a probe placed in the ear canal to deliver auditory stimuli and to measure the response of the sensory cells with a sensitive microphone. OAE screening devices have technology that allows them to discriminate between randomly occurring OAEs, OAEs created by interfering room noise present in the test environment, and the OAEs that are a response to specific test stimuli. Automated OAE screening devices are capable of filtering non-specific OAEs in order to detect and analyze the OAEs that lead to an accurate screen of the infant s hearing. While a PASS test result indicates a proper functioning cochlea, a REFER test result indicates that the OAEs are absent or small compared to normal data. A REFER test result indicates that the patient should be referred to an Audiologist or ENT for further diagnostic evaluation. OAE technology is unable to detect hearing disorders affecting the neural pathways, such as auditory neuropathy. Estimates of the incidence rate of auditory neuropathy among hearing impaired newborns vary widely, but are thought to be in the range of 5% to 15%.

Newborn Hearing Screening Product Lines

Our newborn hearing screening product lines consist of the ALGO, ABaer, AuDX, and Echo-Screen newborn hearing screeners. These hearing screening products utilize proprietary signal detection technologies to provide accurate and non-invasive hearing screening for newborns and are designed to detect hearing loss at 35 dB nHL or higher. Each of these devices is designed to generate a PASS or REFER result.

ALGO 5 and 3i Newborn Hearing Screeners. These AABR devices deliver thousands of soft audible clicks to the newborn s ears through sound cables and disposable earphones connected to the instrument. Each click elicits an identifiable brain wave, which is detected by disposable electrodes placed on the head of the child and analyzed by the screening device. These devices use our proprietary AABR signal detection algorithm.

ABaer Newborn Hearing Screener. The ABaer, which is a PC-based newborn hearing screening device, offers a combination of AABR, OAE, and diagnostic ABR technologies in one system. The automatic ABR technology utilizes our patented Point Optimized Variance Ratio (POVR) signal detection algorithm developed by the House Ear Institute. Like our ALGO newborn hearing screeners, this device delivers thousands of soft audible clicks to the newborn s ears through sound cables and disposable earphones. Each click elicits an identifiable brain wave, which is detected by disposable electrodes placed on the head of the child and analyzed by the screening device. The ABaer OAE software is the same technology used in our AuDX product and the diagnostic ABR software is the same technology used in our Navigator diagnostic hearing assessment product.

AuDX and Echo-Screen. Our AuDX product is a hand-held OAE screening device that can be used for newborn hearing screening, as well as for patients of all ages, from children through adults. Our Echo-Screen product is a hand-held combination AABR and OAE device for newborn screening that can also used for children through adults in OAE only mode. These devices record and analyze OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient s ear canal. OAE technology is unable to detect hearing disorders affecting the neural pathways, such as auditory neuropathy.

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Hearing Screening Supply Products

For infection control, accuracy, and ease of use, the supply products used with our newborn hearing screening devices are designed as single-use, disposable products. Each screening supply product is designed for a specific hearing screening technology.

ABR Screening Supply Kits. Each ABR screen is carried out with single-use earphones and electrodes, which are alcohol and latex-free. The adhesives used in these supply products are specially formulated for use on the sensitive skin of newborns. To meet the needs of our customers we offer a variety of packaging options.

OAE Supply Products. Each OAE screen is carried out with single-use ear tips that are supplied in a variety of sizes and packaging options.

Diagnostic Hearing Assessment

Overview

We design and manufacture a variety of products used to screen for or diagnose hearing loss, or to identify abnormalities affecting the peripheral and central auditory nervous systems. The technology used in most of these systems is either electrodiagnostic in nature or measures a response from the cochlea known as an OAE.

Electrodiagnostic systems record electrical activity generated in the central nervous system. An electrodiagnostic testing device delivers acoustic stimuli to the ears while electrodes placed on the scalp record the brain s electrical response. The most common auditory test performed with electrodiagnostic equipment is the ABR test. This test, which records brainwaves that correspond to responses from the inner ear and brainstem, is used to screen for and define hearing loss characteristics, particularly for patients who cannot reliably respond to standard behavioral tests of hearing, either verbally or through motor response. A technician with minimal training can operate an instrument that performs an automated ABR screening test. More advanced ABR testing techniques that either define the nature of the hearing loss or that screen for other auditory abnormalities such as an acoustic tumor, require the expertise of a trained clinician, usually an audiologist or an ENT physician, an understanding of the technology being used, and the ability to interpret complex waveforms that represent the brain s electrical activity.

Diagnostic Hearing Assessment Product Lines

Our diagnostic hearing assessment products consist of the Navigator Pro system, the Scout Sport portable diagnostic device, the HINT PRO, the AuDX PRO and the Cochlea-Scan.

Navigator PRO. Our Navigator PRO for hearing assessment consists of a base system that is augmented by discrete software applications that are marketed as enhancements to the system. The Navigator Pro System is a PC-based, configurable device that utilizes evoked potentials, which are electrical signals recorded from the central nervous system that appear in response to repetitive stimuli, such as a clicking noise. The evoked potentials are used to record and display human physiological data associated with auditory and hearing-related disorders. The Navigator Pro System can be used for patients of all ages, from children to adults, including infants and geriatric patients. The device can be configured with additional proprietary software programs for various applications. These additional software programs include: CHAMP, MASTER, AEP, VEMP, BioMAP, ABaer and Scout.

Scout SPORT. The Scout SPORT is a PC-based OAE system. The ultra portable Scout Sport can be carried from one computer to another to test in different locations. For office-based environments, the Scout Sport can be used with a dedicated notebook computer to create an independent portable system.

HINT PRO. Our Hearing in Noise Test (HINT) application uses test sentences, procedures, and headphone norms developed by the House Ear Institute. The system features computerized

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administration, scoring, report generation, and data storage. The HINT measures the patient s ability to recognize and repeat short sentences presented in quiet or in noise. The speech and noise sources can be spatially separated to measure binaural directional hearing and spatial unmasking. The patient s sentence recognition threshold is measured in quiet and in three noise conditions.

AuDX PRO. The AuDX Pro is a hand-held OAE screening device with a large color display that can be used for patients of all ages. The AuDX records and analyzes OAEs generated by the cochlea through sound cables and disposable ear probes inserted into the patient s ear canal. A REFER test result indicates that the patient should be referred to an Audiologist or ENT for further diagnostic evaluation.

Cochlea-Scan. The Cochlea-scan is an easy to use handheld device to assess hearing loss. It utilizes Distortion Product OAE technology, which allows the user to quantify hearing loss using physiologic measures instead of relying upon a patient s behavioral response.

Diagnostic Hearing Supply Products

For infection control, accuracy, and ease of use, most supply products used with our diagnostic hearing devices and systems are designed as single-use, disposable products. Each screening supply product is designed for a specific diagnostic hearing technology, and is similar in nature to our previously described OAE supply products for use in newborn hearing screening.

Monitoring Systems for Neurology

Our monitoring systems for Neurology represent a comprehensive line of products that are used by physicians, nurses and medical technologists to assist in the diagnosis and monitoring of neurological disorders of the central and peripheral nervous system, and as an aid in monitoring patients during surgery, while under sedation, or in post-operative care. Our product lines consist of the following:

Electroencephalography or EEG Equipment that monitors and visually displays the electrical activity generated by nerve cells in the brain for both diagnosis and monitoring of neurological disorders in the hospital, laboratory, office or patient s home;

Polysomnography or PSG Equipment that measures a variety of respiratory and neurological functions to assist in the diagnosis and monitoring of sleep disorders, such as snoring and obstructive sleep apnea, a condition that causes a person to stop breathing intermittently during sleep;

Electromyography or EMG Equipment that measures electrical activity in nerves, muscles, and the spinal cord; and

Intra-operative Monitoring or IOM Products that assist surgeons in preserving the functional integrity of a patient s nervous system during and after complex surgical procedures.

Diagnostic EEG Monitoring

Overview

We design, manufacture, and market a full line of computerized instruments used to help diagnose the presence of seizure disorders and epilepsy, look for causes of confusion, evaluate head injuries, tumors, infections, degenerative diseases, and metabolic disturbances that affect the brain, and assist in surgical planning. This type of testing is also done to diagnose brain death in comatose patients. These systems and instruments work by detecting, amplifying, and recording the brain s electrical impulses (EEGs). Routine EEG recording is done by placing electrodes on a patient s scalp over various areas of the brain to record and detect patterns of activity and specific types of electrical events. EEG technologists perform the tests, and neurologists review and interpret the results.

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Routine outpatient EEG testing is performed both in private physicians offices and hospital neurology laboratories, providing physicians with a clinical assessment of a patient s condition. For patients with seizures that do not respond to conventional therapeutic approaches, long-term inpatient testing of EEGs and behavior is used to determine if surgical solutions are appropriate.

Diagnostic Electroencephalograph (EEG) Monitoring Product Lines

Our diagnostic EEG monitoring product lines for neurology consist of devices operating with our proprietary software, augmented by signal amplifiers. These products are typically used in concert, as part of an EEG system by the neurology department of a hospital to assist in the diagnosis of assorted neurological conditions.

NeuroWorks; Ceegraph VISION; Coherence; Harmonie. Our computerized EEG Systems include a broad range of products, from software licenses and ambulatory monitoring systems to advanced laboratory systems with multiple capabilities for EEG, ICU monitoring, long-term epilepsy monitoring of up to 128 channels, and physician review stations with quantitative EEG analysis capabilities.

Stellate/Gotman Spike and Seizure; GridView. Our proprietary Spike and Seizure detection algorithm detects, summarizes, and reports EEG events that save health care professionals time by increasing the speed and accuracy of interpretation. GridView is a tool that allows the clinician to correlate EEG patterns with electrode contacts on a 3D view of the patient brain using magnetic resonance (MR) or computed tomography (CT) images, thus enabling the visualization and annotation of the brain surface and internal structures involved in the diagnosis of epilepsy.

Proprietary Signal Amplifiers. Our proprietary signal amplifiers function as the interface between the patient and the computer, and are also known as the headbox . The headbox connects electrodes attached to the patient s head to our EEG monitoring systems. Our proprietary headbox products are sold for a wide variety of applications under the following brand names: Bio-logic Netlink and Netlink Traveler, Xltek Trex, EEG32, EMU128, EMU40, Brain Monitor and Schwarzer epas. Recent innovations in electronics technology and advanced internet-protocol data transmission enable certain of our amplifiers to record and transmit up to 32 channels of digital data using Ethernet communication.

Several additional options are available to enhance our EEG products, including: a digital video option, which provides synchronized video recording of a patient s behavior while recording electrical activity from the brain; our patented SmartPack software option, which is an innovative data compression process that reduces the size of data files by as much as 60%, and our Universal Reader which is a physician s review station that permits fast and easy data analysis in a graphical format.

Diagnostic PSG Monitoring

Overview

Increasing public awareness of sleep disorders has made sleep medicine a rapidly growing specialty. The analysis of respiratory patterns, brain electrical activity and other physiological data has proven critical for the diagnosis and treatment of sleep-related diseases such as apnea, insomnia, and narcolepsy. A sleep study entails whole-night recordings of brain electrical activity, muscle movement, airflow, respiratory effort, oxygen levels, electrical activity of the heart (ECG or EKG), and other parameters. These recordings typically result in over 1,000 pages of data that are reviewed, analyzed, and scored by a technician, and summarized in a report for the physician. We market configured laboratory systems, portable systems, and ambulatory recorders for home monitoring.

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Diagnostic PSG Monitoring Product Lines

Our diagnostic PSG monitoring products can be used individually or as part of a networked system for overnight sleep studies to assist in the diagnosis of sleep disorders. These products include software licenses, ambulatory monitoring systems, and laboratory systems that combine multiple capabilities, including EEG monitoring, physician review stations, and quantitative EEG analysis capabilities.

Sleepscan VISION; SleepWorks; Coherence and Harmonie. Our diagnostic PSG systems capture and store all data digitally and provide time-saving features and software for acquiring and analyzing the data. The systems enable users to specify rules and personal preferences to be used during analysis, summarizing the results graphically and incorporating them in detailed reports. Software packages include customized analysis, tools and interfaces with third party equipment.

Proprietary Amplifiers. Our data acquisition systems incorporate recent developments in superior amplifiers for sleep analysis. Sold under the brand names Xltek Trex and Connex, Bio-logic Netlink and Netlink Traveler, Schwarzer epas duo 44 and comlab PSG, our amplifiers are used in stand-alone clinics and hospital settings. In addition to exceptional signal quality, headboxes include various tools such as built-in oximeters, and controls to allow the user to start and stop a study or perform electrode impedance testing either at the patient s bedside or from the monitoring room.

We also market a broad line of disposable products and accessories for the PSG laboratory. The Airflow Pressure Transducer uses pressure changes as an indicator of patient airflow levels, as contrasted to other monitoring devices that use temperature to indicate these levels. This product detects shallow breathing in situations where temperature related transducers might remain substantially unchanged. This method has been documented in industry publications to produce the signature waveform used in identifying a respiratory disorder known as Upper Airway Resistance Syndrome.

DiagnosticEMG Monitoring

Overview

An electromyogram measures the electrical activity of muscles both at rest and during contraction. Measuring the electrical activity in muscles and nerves can help diagnose diseases that damage muscle tissue or nerves. An electromyogram is done to determine if there is any disease present that damages muscle tissue, nerves, or the junctions between nerve and muscle (neuromuscular junctions). An electromyogram can also be used to diagnose the cause of weakness, paralysis, and muscle twitching and is also used as a primary diagnosis for carpal tunnel syndrome, which is the most frequently encountered peripheral compressive neuropathy.

Diagnostic EMG Product Lines

Xltek NeuroMax. A dedicated EMG device focused entirely on signal quality and clinical efficiency. The device gathers neurophysiological data that is saved to a fully customizable report, allowing physicians to take care of patients with the most informed advice.

Xltek XCalibur. An EMG system that uses advanced circuit design and digital signal processing to deliver clean signals, making the process of acquiring patient data reliable and quick. The system provides enhanced data acquisition, reporting, and review capabilities.

Schwarzer Topas. The topas system offers a wide range of sophisticated EMG and evoked potential (EP) examination protocols, as well as an attractive and functional design. Topas can be configured as a two or four channel system, as trolley-based or portable version, depending on the needs of the hospital or private practice.

Dantec Keypoint. The Dantec Keypoint EMG and EP family of products feature superior amplifiers, stimulators, and outstanding signal quality. The Keypoint is used for advanced neurodiagnostic applications such as single fiber EMG, visual and auditory evoked potentials, and in routine nerve conduction studies. The Keypoint system is also available in a portable laptop configuration.

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Dantec Clavis. The Dantec Clavis is a hand-held EMG and current stimulation (STIM) device that provides muscle and nerve localization information to assist with botulinum toxin injections (i.e. Botox). In conjunction with the Bo-ject hypodermic needle and electrodes, it delivers a precise dose of the agent.

IOM

Overview

Intra-operative monitoring is the use of electrophysiological methods such as EMG and EEG to monitor the functional integrity of neural structures (brain, nerves, spinal cord) during surgery. The most common applications are in neurosurgery such as spinal surgery, some brain surgeries, ENT procedures, and peripheral nerve surgery. IOM is used to localize neural structures and test the function of these structures for early detection of intra-operative injury, allowing for immediate corrective measures.

Intra-operative Monitoring Products

Protektor. The protector is an IOM system that provides medical professionals with all information necessary to make immediate and critical surgical decisions. The system combines flexibility with multi-modality allowing full coverage of IOM techniques.

Balance and Mobility

Overview

Balance disorders impact a large percentage of the population in all age ranges from children to adults. Common complaints include dizziness, vertigo, or an inability to walk or drive a vehicle, which can all lead to the curtailment of daily life activities. These symptoms are exacerbated in elderly patients and can result in falls, orthopedic injuries, and sometimes death.

Balance problems are difficult to diagnose and treat because they can be caused by a combination of diseases or movement dysfunctions. Healthcare professionals who take a traditional clinical approach to the examination and treatment of balance problems typically explore one component of the balance system at a time. This approach often requires patients to consult multiple specialists, leading to patient dissatisfaction and increased health care costs, frequently without achieving an optimal outcome.

We believe the most effective strategy for diagnosing and treating balance disorders is an evidence-based, multidisciplinary approach applying a broad range of patient information. Our Balance Manager systems are designed to facilitate the assessment and management of complex balance problems in the context of the total patient to support this process. These systems are used in a broad spectrum of medical disciplines including otolaryngology, neurology, physiatry, orthopedics/sports medicine, geriatrics, and physical rehabilitation.

Balance and Mobility Products

Our principal balance and mobility products are sold under the Neurocom brand:

EquiTest. Proprietary protocols in the EquiTest family of devices objectively quantify and differentiate among sensory, motor, and central adaptive impairments to balance control. This approach is commonly referred to as computerized dynamic posturography (CDP). CDP is complementary to clinical tests designed to localize and categorize pathological mechanisms of balance disorders in that it can identify and differentiate the functional impairments associated with the identified disorders.

Balance Master. A family of devices providing objective assessment and retraining of the sensory and voluntary motor control of balance. With visual biofeedback on either a stable or dynamic support

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surface and in a stable or dynamic visual environment, the clinician can both assess and retrain patients performing tasks ranging from essential daily living activities through high-level athletic skills. The objective data captured by the device supports the design of effective treatment and/or training programs focused on the specific sensory and motor components underlying a patient s functional limitations.

inVision. Our inVision device incorporates a set of proprietary diagnostic tests that quantify a patient s ability to maintain visual acuity and stable gaze while actively moving the head. The objective information enables the clinician to assess the patient s ability to live and move safely in a dynamic world and to participate in daily-life functions such as driving, walking through a grocery store, or actively engaging in family activities.

Newborn Care

Newborn Care Products

We manufacture a wide variety of products used in the medical care of newborns. These product lines include products to diagnose and treat newborn brain injury, as well as phototherapy lights to treat newborn jaundice. We also sell a variety of newborn care products to meet the needs of clinicians in the nursery and NICU.

Newborn Brain Injury

Overview

For many years, newborn infants admitted to the NICU of a hospital have routinely been monitored for heart activity, temperature, respiration, oxygen saturation, and blood pressure. Only recently has it also been considered important to monitor brain activity using continuous EEG. A cerebral function monitor, utilizing amplitude-integrated EEGs (aEEGs), is a device for monitoring background neurological activity.

Neurological Assessment and Treatment Options

Early diagnosis of brain injury in newborns, when combined with early intervention, has been shown to reduce the severity of these brain injuries and in some cases, save the patient s life. These brain injuries, which can occur in as many as three out of every 1,000 newborns, are caused by conditions such as hypoxic ischemic encephalopathy (HIE), subclinical seizures, or neurological disorders. Diagnosing these conditions shortly after birth is imperative, as patients who undergo therapy within six hours after birth show a greater potential for improved outcomes. We believe that diagnoses utilizing aEEG technology can have a marked and positive impact upon the outcomes of some newborns suffering from brain injury.

Newborn Brain Injury Product Line

Olympic CFM-6000 System. The Cerebral Function Monitor (CFM) allows the Neonatologist to diagnose neurological disorders or brain injury in the newborn. The device continuously monitors and records brain activity, aiding in the detection and treatment of HIE and seizures. The device also monitors the effects of drugs and other therapies on brain activity and improves the accuracy of newborn neurological assessments. The Olympic CFM-6000 helps determine the need for further neurological examination or transport to a tertiary-care center. The CFM is used with electrodes attached to the head of the newborn to acquire an EEG signal that is then filtered, compressed, and displayed graphically on the device or as a hardcopy printout.

Brainz BRM3. The Brainz BRM3 is a bedside monitor that collects and measures electrical activity from both the right and left hemispheres of the brain. The monitor presents a simplified 2-channel EEG display, along with the option to view three channels of time-compressed, aEEG. The BRM3 has the ability to collect EEG and aEEG data from both hemispheres of the brain providing practitioners with the ability to monitor infants with a

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wider variety of neurological concerns when compared to single channel EEG. For ease of use at the bedside, the BRM3 has a touch screen for easy navigation and an onscreen keyboard for quick data entry. The straightforward set up and compact design of the BRM3 makes it an ideal tool for clinicians to initiate neurological monitoring and aEEG trending.

Olympic Cool-Cap System. The Olympic Cool-Cap is the only FDA approved device for the treatment of moderate to moderately-severe HIE. A four-year clinical trial for the Cool-Cap was completed in 2003, and the FDA gave approval for the product in December 2006. The clinical trial validated the benefit of selective head cooling as a means of reducing the temperature of the brain to diminish the severity of brain injury resulting from HIE in newborns. The device conforms to the clinical trial protocol and is designed to assist the clinician in safely administering treatment, thereby preventing or significantly reducing the severity of neurological injury associated with HIE.

Newborn Brain Injury Supply Products. In addition to disposable electrodes used to perform each EEG test using the CFM-6000 and the BRM3, the Olympic Cool-Cap brain cooling system uses a single-patient, disposable, cooling cap to continuously circulate sterile water to the patient during the 72-hour treatment period.

Jaundice Management Products

Overview

The American Academy of Pediatrics estimates that each year 60% of the approximately four million newborns in the U.S. become jaundiced. According to the Journal of the American Medical Association, neonatal jaundice is the single largest cause for hospital readmission of newborns in the U.S., and accounts for 50% of readmissions. Because of the serious consequences of hyperbilirubinemia, the American Academy of Pediatrics recommends that all newborns be closely monitored for jaundice and has called for the physician to determine the presence or absence of an abnormal rate of hemolysis to establish the appropriate treatment for the newborn.

In 2004, the American Academy of Pediatrics issued new guidelines for the treatment of jaundice in newborns. The guidelines recommend phototherapy as the standard of care for the treatment of hyperbilirubinemia in infants born at 35 weeks or more of gestation. The guidelines further highlight the need for intense phototherapy, and specifically recommend the use of the blue light treatment incorporated into our neoBLUE products.

We currently offer the following products that meet guidelines of the American Academy of Pediatrics for the treatment of newborn jaundice:

neoBLUE Product Family. This product line consists of our neoBLUE, neoBLUE Mini, and neoBLUE Cozy devices, which utilize light emitting diodes (LEDs) to generate a high-intensity, narrow spectrum of blue light that is clinically proven to be most effective in the treatment of newborn jaundice. The neoBLUE phototherapy devices emit significantly less ultraviolet light and heat than conventional phototherapy devices, reducing the risk of skin damage and dehydration for infants undergoing treatment. Because of the high intensity of these lights, the treatment time associated with phototherapy is reduced.

Bili-Lite Product Family. These devices utilize fluorescent light bulbs for the treatment of hyperbilirubinemia. The Bili-Bassinet provides intensive phototherapy from both under and over the baby for maximum surface area coverage. The Bili-Lite pad is a product designed for both hospital and home-based phototherapy.

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Other Newborn Care Product Lines

Medical Devices. These products include devices such as: photometers, radiometers, patient warming lamps, neonatal heatshields, pediatric scales, blanket warming cabinets, exam lights, oxygen hoods, restraining boards, and our newborn circumstraint.

Hawaii Medical Products. These single-use disposable products are sold into the NICU and nursery in hospitals. The Hawaii Medical line includes Gumdrop pacifiers, TootSweet sucrose solution and NeatNick heel lancets, among a range of positioning devices, electrodes and other newborn care products.

Disposable Supplies. These products include other disposable supplies such as: neonatal noise attenuators, phototherapy eye masks and x-ray shields for newborn gonads.

Newborn Screening Data Management Product Line. Our suite of newborn screening data management products consists of proprietary software that collects, tracks, manages and reports newborn screening data to regional government health laboratories and national disease control centers. While all states have laws and/or regulations requiring newborn screening for metabolic disorders, the laws and regulations vary widely in the extent of screening required. Some states use tandem mass spectrometry in their newborn metabolic screening programs, which increases the number of treatable disorders that can be detected. Revenue from installation and upgrades of our newborn screening data management systems is classified as devices and systems revenue, and revenue from maintenance contracts on the systems is classified as supplies and services revenue.

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 in turn, resell our products to end users or sub-distributors.

Information regarding our sales and long-lived assets in the U.S. and in countries outside the U.S. is contained in *Note 16 Segment, Customer and Geographic Information* of our consolidated financial statements included in this report and is incorporated in this section by this reference.

Revenue by Product Family and Product Category

For the years ended December 31, 2009, 2008 and 2007, revenue from our four product families as a percent of total revenue was approximately as follows:

	Year Ended December 31,		
	2009	**2008**	**2007**
Hearing	40%	41%	53%
Monitoring Systems for Neurology	39%	34%	14%
Newborn Care	16%	19%	28%
Other	5%	6%	5%
Total	100%	100%	100%

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We also look at revenue as either being generated from sales of Devices and Systems, which are generally non-recurring, or related Supplies and Services, which are generally recurring. The products that are attributable to these categories are described above. Revenue from Devices and Systems, and Supplies and Services, as a percent of total revenue for the years ending December 31, 2009, 2008 and 2007 is as follows:

	Year Ended December 31,		
	2009	2008	2007
Devices and Systems	58%	63%	62%
Supplies and Services	40%	35%	37%
Other	2%	2%	1%
Total	100%	100%	100%

In 2009, 2008 and 2007, sales to no single end-user customer comprised more than 10% of our revenue, and revenue from services was less than 10% of our revenue.

Backlog

As of December 31, 2009, our backlog was approximately $8.9 million, compared to $2.1 million at December 31, 2008 and $4.4 million at December 31, 2007. We anticipate that we will complete all of the backlog orders by the fourth quarter of 2010.

Marketing and Sales

Marketing

Our marketing strategy differentiates our products by their level of quality, performance, and customer benefit. We educate customers and potential customers worldwide about our products through several traditional methods, including, but not limited to:

- Trade conference exhibits;
- Direct presentations to healthcare professionals;
- Publications in professional journals and trade magazines;
- The Internet via our website, *www.natus.com;*
- Print and direct mail advertising campaigns; and
- Sponsorship of and participation in clinical education seminars.

Educational efforts directed at government agencies, physicians, and clinicians about the benefits of universal screening in terms of patient outcomes and long-term treatment costs are a key element of our marketing strategy.

Domestic Direct and Distributor Sales

We sell our products in the United States primarily through a direct sales organization. We believe this direct sales organization allows us to maintain a higher level of customer service and satisfaction than would otherwise be possible by other distribution methods. We also sell certain

products under private label and distribution arrangements.

Domestic revenue as a percent of total revenue was 66%, 69%, and 67% in 2009, 2008 and 2007, respectively.

As a percent of total revenue, domestic sales through our direct and other sales channels, respectively, was 59% and 7% in 2009, 62% and 7% in 2008, and 57% and 10% in 2007.

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International Direct and Distributor Sales

We sell some of our products outside the U.S. through direct sales channels in the French and German speaking regions of Europe, and in Denmark, and sell other products in those regions and into more than 100 other countries through a distributor sales channel.

International revenue as a percent of total revenue was 34%, 31%, and 33% in 2009, 2008 and 2007, respectively.

As a percent of total revenue, international sales through our direct and other sales channels, respectively, was 8% and 26% in 2009, 16% and 15% in 2008, and 14% and 19% in 2007.

We sell products to our distributors under substantially the same terms as sales through our direct sales channels. Terms of sales to international distributors are EXW, reflecting that goods are shipped ex works, in which title and risk of loss are assumed by the distributor at the shipping point. Distributors are generally given exclusive rights in their territories to purchase products from Natus and resell to end users or sub distributors. Our distributors typically perform marketing, sales, and technical support functions in their respective markets. Each distributor may sell Natus products to their customer directly, via other distributors or resellers, or both. We actively train our distributors in product marketing, selling, and technical service techniques.

Seasonality in Revenue

We experience seasonality in our revenue. Our revenue typically drops from our fourth quarter to our first quarter. This seasonality results from the purchasing habits of our hospital-based customers, whose purchases are often governed by calendar year budgets, and the manner in which our direct sales force is compensated, as their compensation is based on annual sales plans that are tied to our December year end.

Group Purchasing Organizations

More than 90% of the hospitals in the U.S. are members of group purchasing organizations (GPO s), which negotiate volume purchase prices for member hospitals, group practices, and other clinics. Direct purchases by GPO members accounted for approximately 24%, 31% and 35% of our revenue in 2009, 2008 and 2007, respectively. Direct purchases by members of one GPO, Novation, accounted for approximately 8%, 10% and 9% of our revenue in 2009, 2008 and 2007, respectively. Our revenue recognition policies related to sales to GPO members are described in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in this report.

Third-Party Reimbursement

In the U.S., health care providers generally rely on third-party payors, including private health insurance plans, federal Medicare, state Medicaid, and managed care organizations, to reimburse all or part of the cost of the procedures they perform. Third-party payors can affect the pricing or the relative attractiveness of our products by regulating the maximum amount of reimbursement these payors provide for services utilizing our products. For this reason, we are not able to measure a reimbursement success rate for our products.

Customer Service and Support

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

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Manufacturing

Other companies manufacture a significant portion of the components used in our products; however, we perform final assembly, testing, and packaging of most of the devices ourselves to control quality and manufacturing efficiency. We also use contract vendors to manufacture some of our disposable supply and medical device products. We perform regular quality audits of these vendors.

We purchase materials and components from qualified suppliers that are subject to our quality specifications and inspections. We conduct quality audits of our key suppliers, several of which are experienced in the supply of components to manufacturers of finished medical devices, or supplies for use with medical devices. Most of our purchased components are available from more than one supplier.

Our manufacturing, service, and repair facilities are subject to periodic inspection by federal, state, and foreign regulatory authorities. Our quality assurance system is subject to regulation by the FDA and other state government agencies. We are required to conduct our product design, testing, manufacturing, and control activities in conformance with the FDA s quality system regulations and to maintain our documentation of these activities in a prescribed manner. In addition, our production facilities have received ISO 13485 certification. ISO 13485 certification standards for quality operations have been developed to ensure that medical device companies meet the standards of quality on a worldwide basis. We have also received the EC Certificate pursuant to the European Union Medical Device Directive 93/42/EEC, which allows us to place a CE mark on our products.

Research and Development

We are committed to introducing new products and supporting current product offerings in our markets through a combination of internal as well as external efforts that are consistent with our corporate strategy.

Internal product development capabilities. We believe that product development capabilities are essential to provide our customers with new product offerings. We plan to leverage our core technologies by introducing product line extensions as well as new product offerings.

Partnerships that complement our expertise. We continue to seek strategic partners in order to develop products that may not otherwise be available to us. By taking advantage of our core competencies, we believe that we can bring products to market in an efficient manner and leverage our distribution channels.

New opportunities through technology acquisition. We continue to evaluate new, emerging, and complementary technologies in order to identify new product opportunities. With our knowledge of our current markets we believe that we can effectively develop technologies into successful new products.

Our research and development expenses were $16.7 million or 10.0% of total revenue in 2009, $15.6 million or 9.6% of total revenue in 2008, and $15.6 million or 13.2% of total revenue in 2007.

Proprietary Rights

We protect our intellectual property through a combination of patent, copyright, trade secret, and trademark laws. We attempt to protect our intellectual property rights by filing patent applications for new features and products we develop. We enter into confidentiality or license agreements with our employees, consultants, and corporate partners, and seek to control access to our intellectual property, distribution channels, documentation, and other proprietary information. However, we believe that these measures afford only limited protection.

The intellectual rights to some of the original patents for technology incorporated into our products are now in the public domain. However, we do not consider these patents, or any currently viable patent or related group of patents, to be of such importance that their expiration or termination would materially affect our business.

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We capitalize the cost of purchased technology and intellectual property, as well as certain costs incurred in obtaining patent rights, and amortize these costs over the estimated economic lives of the related assets.

Competition

We sell our products in competitive and rapidly evolving markets. 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.

We derive a significant portion of our revenue from the sale of disposable supplies that are used with our medical devices. In the U.S., we sell our supply products in a mature market. Because these products can generate high margins, we expect that our products, particularly our hearing screening supply products, could face increasing competition, including competitors offering lower prices, which could have an adverse affect on our revenue and margins.

We believe the principal factors that will draw clinicians and other buyers to our products, include:

Level of specificity, sensitivity, and reliability of the product;

Time required to obtain results with the product, such as to test for or treat a clinical condition;

Relative ease of use of the product;

Depth and breadth of the products features;

Quality of customer support for the product;

Frequency of product updates;

Extent of third-party reimbursement of the cost of the product or procedure;

Extent to which the products conform to standard of care guidelines; and

Price of the product.

We believe that our primary competitive strength relates to the functionality and reliability of our products. Different competitors may have competitive advantages in one or more of the categories listed above and they may be able to devote greater resources to the development, promotion, and sale of their products.

Government Regulation

FDA s Premarket Clearance and Approval Requirements

Unless an exemption applies, the medical devices we sell in the United States, with the exception of some disposable products, must first receive one of the following types of FDA premarket review authorizations under the Food, Drug, and Cosmetics Act, as amended:

Clearance via Section 510(k); or

Premarket approval via Section 515 if the FDA has determined that the medical device in question poses a greater risk of injury.

The FDA s 510(k) clearance process usually takes from three to 12 months, but can take longer. The process of obtaining premarket approval via Section 515 is much more costly, lengthy, and uncertain. Premarket approval generally takes from one to three years, but can take longer. We cannot be sure that the FDA will ever grant either 510(k) clearance or premarket approval for any product we propose to market in the United States.

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The FDA decides whether a device must undergo either the 510(k) clearance or premarket approval process based upon statutory criteria. These criteria include the level of risk that the Agency perceives to be associated with the device and a determination of whether the product is a type of device that is substantially equivalent to devices that are already legally marketed. The FDA places devices deemed to pose relatively less risk in either class I or class II, which requires the manufacturer to submit a premarket notification requesting 510(k) clearance, unless an exemption applies. The premarket notification under Section 510(k) must demonstrate that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a previously cleared 510(k) device or a device that was in commercial distribution before May 28, 1976 for which the FDA has not yet called for the submission of premarket approval applications.

The FDA places devices deemed to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed to be not substantially equivalent to a predicate device, in its Class III classification. The FDA requires these devices to undergo the premarket approval process via Section 515 in which the manufacturer must prove the safety and effectiveness of the device. A premarket approval application must provide extensive pre-clinical and clinical trial data.

The FDA may require results of clinical trials in support of a 510(k) submission and generally requires clinical trial results for a premarket approval application. In order to conduct a clinical trial on a significant-risk device, the FDA requires manufacturers to apply for and obtain, in advance, an investigational-device exemption. The investigational-device exemption application must be supported by appropriate data, such as animal and laboratory testing results. If the FDA and the Institutional Review Boards at the clinical trial sites approve the investigational-device exemption application for a significant-risk device, the manufacturer may begin the clinical trial. An investigational-device exemption approval provides for a specified clinical protocol, including the number of patients and study sites. If the manufacturer deems the product a non-significant risk device, the product will be eligible for more abbreviated investigational-device exemption requirements. If the Institutional Review Boards at the clinical trial sites concur with the non-significant risk determination, the manufacturer may begin the clinical trial.

We received approval for our Olympic Cool-Cap product as a Class III device from the FDA through the premarket approval process. Most of our other products have been cleared by the FDA as Class II devices. Some of our disposable products and newborn care products, such as our neonatal headshields and oxygen delivery systems, have received FDA clearance as Class I devices. Our newborn screening data management product line and selected other products are not regulated by the FDA.

FDA Regulation

Numerous FDA regulatory requirements apply to our products. These requirements include:

- FDA quality system regulations which require manufacturers to create, implement, and follow design, testing, control, documentation, and other quality assurance procedures;

- Medical device reporting regulations, which require that manufacturers report to the FDA certain types of adverse and other events involving their products; and

- FDA general prohibitions against promoting products for unapproved uses.

Class II and Class III devices may also be subject to special controls applied to them, such as performance standards, post-market surveillance, patient registries, and FDA guidelines that may not apply to Class I devices. We believe we are in compliance with applicable FDA guidelines, but we could be required to change our compliance activities or be subject to other special controls if the FDA changes existing regulations or adopts new requirements.

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We are subject to inspection and market surveillance by the FDA to determine compliance with regulatory requirements. If the FDA finds that we have failed to adequately comply, the Agency can institute a wide variety of enforcement actions, including:

- Issuance of a Form 483 citation;
- 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 510(k) clearance or pre-market approval of new products;
- Withdrawal of 510(k) clearance or pre-market approval already granted; or
- Criminal prosecution.

The FDA also has the authority to require us to repair, replace, or refund the cost of any medical device manufactured or distributed by us.

Other U.S. Regulations

We also must comply with numerous additional federal, state, and local laws relating to matters such as safe working conditions, manufacturing practices, environmental protection, biohazards, fire hazard control, and hazardous substance disposal. We believe we are currently in compliance with such regulations.

Foreign Regulation

In the foreign countries in which we sell or plan to sell our FDA-regulated products, these products are also regulated as medical devices and are subject to regulatory requirements by foreign governmental agencies similar to those of the FDA. Our manufacturing facilities are audited and have been certified to be 13485:2003 International Standard for Medical Devices and Device Directive 93/42/EEC, Annex II, Section 3.2 compliant, which allows us to sell our products in Europe and Canada. Our manufacturing facilities are subject to CE Mark and ISO 13485 inspection by our notified body, British Standards Institution Management Systems. We plan to seek approval to sell our products in additional countries. The time and cost required to obtain market authorization from other countries and the requirements for licensing a product in another country may differ significantly from FDA requirements.

Employees

On December 31, 2009, we had 635 full time employees worldwide. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our relations with our employees to be good.

Executive Officers

The following table lists our executive officers and their ages as of March 1, 2010:

Name	Age	Position(s)
James B. Hawkins	54	President, Chief Executive Officer, and Director
Steven J. Murphy	58	Vice President Finance and Chief Financial Officer
William L. Mince	58	Vice President North American Operations
Kenneth M. Traverso	49	Vice President Marketing and Sales
D. Christopher Chung, M.D.	46	Vice President Medical Affairs and R&D

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James B. Hawkins has served as President and Chief Executive Officer, and as a member of the Board of Directors, since joining Natus in April 2004. Mr. Hawkins has over 25 years of combined medical device and financial management experience. Prior to joining Natus, he was President and Chief Executive Officer of Nasdaq-traded Invivo Corporation for 19 years. Invivo Corporation, a maker of multi-parameter vital sign monitoring equipment used in hospitals, was acquired in early 2004 by Intermagnetics General Corporation. He earned a Bachelor of Commerce degree, specialized in Management from Santa Clara University and a Masters of Business Administration - Finance degree from San Francisco State University. Mr. Hawkins is a Director of Iridex Corp.

Steven J. Murphy has served as Chief Financial Officer since February 2006, Vice President Finance since June 2003, and joined Natus in September 2002 as Director of Finance. From February 2002 through September 2002, Mr. Murphy was interim Controller at Travel Nurse International, a temporary staffing firm that was acquired by Medical Staffing Network in December 2002. From October 1998 through January 2002, Mr. Murphy was Controller of AdvisorTech Corporation, an international software development company providing IT-based solutions in the field of investments, where he was responsible for financial reporting of domestic, Asian and European operations with significant reporting responsibilities to the board of directors and investor groups. From 1996 to 1998 he was Vice President Finance of RWS Group, LLC, an international service company providing management of language-related projects. Mr. Murphy holds a Bachelor of Science degree in Business Administration from California State University, Chico. Mr. Murphy is a certified public accountant.

William L. Mince has served as our Vice President, North American Operations since September 2007 and joined Natus as Vice President Operations in October 2002. From November 2000 to September 2002, Mr. Mince served as President and Founder of My Own Jukebox, an Internet retail company. From July 1998 to October 2000, Mr. Mince was a consultant with the majority of his time spent as Senior Vice President Network Solutions for Premier Retail Network, a media broadcasting company. From July 1997 to June 1998, Mr. Mince served as President and Chief Operating Officer of Ophthalmic Imaging Systems, a publicly-held medical device company. From July 1994 to June 1997, Mr. Mince was Vice President Operations with Premier Retail Network. From May 1988 to June 1994, Mr. Mince was Director of Operations for Nellcor, a medical device company. Mr. Mince holds a Bachelor of Science degree in Business Administration from the University of Redlands and a Masters of Business Administration degree from National University.

Kenneth M. Traverso has served as our Vice President Marketing and Sales since April 2002. From September 2000 to April 2002, he served as our Vice President Sales. From October 1999 to July 2000, Mr. Traverso served as President of DinnerNow.com Inc., an internet aggregator for the restaurant industry. From January 1998 to September 1999, Mr. Traverso served as Vice President Sales, Western Region of Alere Medical, an outpatient chronic disease management company. From May 1995 to January 1998, Mr. Traverso served as Vice President Marketing and Sales of AbTox, Inc., a low temperature sterilization company. From August 1990 to May 1995, Mr. Traverso served in various capacities at Natus, including Vice President Sales. From September 1984 to July 1990 Mr. Traverso served various positions at Nellcor, a medical device company, including Regional Sales Manager, Western Region. Mr. Traverso holds a Bachelor of Science degree in Administration & Marketing from San Francisco State University.

D. Christopher Chung, M.D., has served as our Vice President Medical Affairs and R&D since June 2003, and has served as our Vice President Medical Affairs since February 2003. Dr. Chung also served as our Medical Director from October 2000 to February 2003. From August 2000 to December 2007, Dr. Chung also served as a Pediatric Hospitalist at the California Pacific Medical Center in San Francisco. Dr. Chung has been a member of the Medical Advisory Board of eHealth Global Technologies, Inc. since April 2007 and has served as a member of their Board of Directors since November 2007. From June 1997 to June 2000, Dr. Chung trained as a pediatric resident at Boston Children s Hospital and Harvard Medical School. From May 1986 to July 1993, Dr. Chung worked as an Engineer at Nellcor, a medical device company. Dr. Chung holds a Bachelor of Arts degree in Computer Mathematics from the University of Pennsylvania and a Doctor of Medicine degree from the Medical College of Pennsylvania-Hahnemann University School of Medicine. He is a licensed physician and is a Fellow of the American Academy of Pediatrics.

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Other Information

Natus was incorporated in California in May 1987 and reincorporated in Delaware in August 2000.

We maintain corporate offices at 1501 Industrial Road, San Carlos, California 94070. Our telephone number is (650) 802-0400. We maintain a corporate website at *www.natus.com*. References to our website address do not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

We make available, free of charge at our corporate website, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and all amendments to these reports, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act. We also show detail about stock trading by corporate insiders by providing access to SEC Forms 3, 4 and 5. This information may also be obtained from the SEC s on-line database, which is located at *www.sec.gov*. Our common stock is traded on the Nasdaq Stock Market under the symbol BABY .

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.

Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008; and Hawaii Medical and Alpine Biomed 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. 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 our acquisitions. Our corporate headquarters are located in San Carlos, California. We also have the following operating divisions: Olympic in Washington; Neurocom in Oregon;

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Bio-logic in Illinois; Neometrics in New York; Xltek and Stellate in Canada; Alpine Biomed in Denmark; Fischer-Zoth, Schwarzer Neurology, and IT-Med (collectively Natus Europe) and Alpine Biomed Germany in Germany; and Deltamed and Alpine Biomed France in France. 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 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 products or technologies with which we have limited previous experience;
- Failure to compete effectively in new markets;
- 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 these acquisitions or investments. In addition, our reported operating results may suffer because of impairment charges incurred to write down the carrying amount of intangible assets, including goodwill, generated as a result of the acquisitions.

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. Economic conditions in the countries in which we operate and sell products worsened and global financial markets subsequently experienced significant volatility and declines throughout much of 2009. 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. This could 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, all of which could impact our results of operations and financial condition. In addition, we expect these factors will cause us to be more cautious in evaluating potential acquisition opportunities, which could hinder our ability to grow through acquisition while these conditions persist.

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.

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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 European operating divisions. Until we have completed this 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.

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. 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.

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

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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 healthcare payment systems. Reimbursement, funding, and healthcare 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.

Healthcare reforms, changes in healthcare policies and changes to third-party reimbursements for our products may affect demand for our products

The U. S. government has in the past considered, is currently considering, and may in the future consider healthcare policies and proposals intended to curb rising healthcare costs, including those that could significantly affect reimbursement for our products. These policies have included, and may in the future include: basing reimbursement policies and rates on clinical outcomes; the comparative effectiveness and costs of different treatment technologies and modalities; imposing price controls and taxes on medical device providers; and other measures. Future significant changes in the healthcare systems in the United States or elsewhere could also have a negative impact on the demand for our current and future products. These include changes that may reduce reimbursement rates for our products and changes that may be proposed or implemented by the current U.S. Presidential administration or Congress. It is unclear which, if any, of the various U.S. healthcare reform policies currently being discussed and/or proposed might be enacted by the U.S. Congress and signed into law by the President.

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;

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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 24%, 31% and 35% of our total revenue during 2009, 2008 and 2007, respectively, and sales to members of one GPO, Novation LLC, accounted for approximately 8%, 10% and 9% of our total revenue in 2009, 2008 and 2007, 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.

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 therefore the amount that they can spend on our equipment products. If budget resources limit the capital spending of our customers, they will be unlikely to either purchase any new equipment from us or upgrade to any of our newer equipment products. Lack of liquidity in credit markets and uncertainty about future economic conditions can have an adverse effect on the spending patterns of our customers. These factors can have a significant adverse effect on the demand for our products.

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.

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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 possible recessions in economies outside the U.S.;

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 healthcare 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

Substantially all of our sales contracts with our U.S. based customers provide for payment in U.S. dollars. With the exception of our Canadian operations, substantially all of the revenue and expenses of our foreign subsidiaries are denominated in the applicable foreign 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.

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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 sales of newborn hearing screening products may not achieve the revenue growth we have achieved in the past

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.

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.

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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. Demand for these skilled employees 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 other countries. 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

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

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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.

Our Olympic Cool-Cap 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.

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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 grows and the functionality of products 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;

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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 may also find it necessary to bring infringement actions against third parties to seek to protect our intellectual property rights. Litigation of this nature, even if successful, is often expensive and disruptive of our management s attention, and in any event may not lead to a successful result relative to the resources dedicated to any such litigation.

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, and the compensation arrangements of our direct sales employees, as those arrangements are tied to calendar-year sales plans. 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.

ITEM 1B. Unresolved Staff Comments.

None.

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ITEM 2. Properties

Our corporate headquarters are located in San Carlos, California, in facilities covering 26,300 square feet pursuant to a lease that expires in June 2015.

We also utilize the following properties:

Company-owned Facilities:

44,900 square feet in Oakville, Ontario, Canada, utilized substantially for the operations of Xltek;

26,000 square feet in Mundelein, Illinois, utilized substantially for the operations of Bio-logic.

Leased Facilities:

65,000 square feet in Seattle, Washington, pursuant to a lease that expires in December 2011, that is utilized substantially for the operations of Olympic Medical;

12,000 square feet in Clackamas, Oregon, pursuant to a lease that expires in April, 2014, that is utilized substantially for the operations of Neurocom;

2,900 square feet in Hauppauge, New York, pursuant to a lease that expires in October 2012, that is utilized substantially for the operations of Neometrics;

14,800 square feet in Montreal, Quebec, Canada, pursuant to a lease that expires in October, 2012, that is utilized substantially for the operations of Stellate.

48,000 square feet in Skovlunde, Denmark, pursuant to a lease that expires with six months notice that is utilized for the operations of Alpine Biomed;

29,000 square feet in Munich, Germany, pursuant to a lease that expires in March, 2012, that is utilized substantially for the operations of Schwarzer Neurology and Fischer-Zoth; and 1,700 square feet in Langenfeld, Germany, pursuant to a lease on a month to month basis, that is utilized substantially for the operations of Alpine Biomed Germany; and

2,700 square feet in Paris and 7,500 square feet in Bordeaux, both in France, pursuant to leases that expire in October 2016, and March 2012, respectively, that are utilized substantially for the operations of Deltamed; and 3,200 square feet in Courtaboeuf Cedex, France pursuant to a lease that expires in September 2016 that is utilized substantially for the operations of Alpine Biomed France.

ITEM 3. 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. We are not currently involved in any legal or administrative proceedings that we believe are likely to have a materially adverse effect on our business, financial condition, or results of operations, although we cannot be assured of the outcome of such matters.

ITEM 4. (Reserved)

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PART II

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on the Nasdaq Global Select Market under the symbol BABY . The following table sets forth, for the periods indicated, the high and low sale price per share of our common stock, as reported on the Nasdaq Global Select Market.

	High	Low
Fiscal Year Ended December 31, 2009:		
Fourth Quarter	$ 16.22	$ 12.59
Third Quarter	17.51	9.92
Second Quarter	11.72	7.08
First Quarter	13.00	6.46
Fiscal Year Ended December 31, 2008:		
Fourth Quarter	$ 22.85	$ 8.95
Third Quarter	26.00	20.50
Second Quarter	22.08	17.83
First Quarter	20.33	16.06

As of March 8, 2010, there were 28,417,196 shares of our common stock issued and outstanding and held by approximately 114 stockholders of record. We estimate that there are approximately 11,200 beneficial owners of our common stock.

Dividends

We have never declared or paid cash dividends on our capital stock. We currently expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Based on the terms of our Amended and Restated Credit Agreement with Wells Fargo Bank, National Association, we are prevented from paying dividends without the prior approval of the bank.

Stock Performance Graph

The following information of Part II Item 5 is being furnished and shall not be deemed to be soliciting material or to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section, nor will it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate such information by reference thereto.

The following graph shows a comparison, from January 1, 2004 through December 31, 2009, of cumulative total return for our common stock, the Nasdaq Composite Index and the Standard & Poor s 500 Health Care Equipment Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the Nasdaq Composite Index and the Standard & Poor s 500 Health Care Equipment Index assumes reinvestment of dividends.

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		2004	2005	2006	2007	2008	2009
Natus Medical Incorporated	Return %		101.74	2.91	16.49	(33.08)	14.21
	Cum $	$ 100.00	$ 201.74	$ 207.60	$ 241.84	$ 161.85	$ 184.85
NASDAQ Composite Total Return	Return %		2.12	10.39	10.65	(39.98)	45.36
	Cum $	$ 100.00	$ 102.12	$ 112.73	$ 124.73	$ 74.87	$ 108.83
S&P 500 Health Care Equipment Index	Return %		0.06	4.11	5.15	(27.63)	28.75
	Cum $	$ 100.00	$ 100.06	$ 104.18	$ 109.54	$ 79.27	$ 102.06

ITEM 6. Selected Financial Data

The following tables set forth certain selected consolidated financial data as of December 31, 2009, 2008, 2007, 2006 and 2005 and for each of the years in the five-year period ended December 31, 2009, and is derived from the consolidated financial statements of Natus Medical Incorporated and its subsidiaries. The consolidated financial statements as of December 31, 2009 and 2008 and for each of the years in the three-year period ended December 31, 2009 are included elsewhere in this report. The selected consolidated balance sheet data as of December 31, 2007, 2006 and 2005 and the consolidated statements of operations data for the years ended December 31, 2006 and 2005 are derived from our consolidated financial statements, which are not included in this report. The selected consolidated financial data set forth below is qualified in its entirety by, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report.

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	Year ended December 31,				
	2009 [i]	2008 [i]	2007 [i]	2006 [i]	2005 [i]
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenue	$ 166,505	$ 161,831	$ 118,374	$ 89,915	$ 43,045
Cost of revenue	66,670	60,933	43,100	33,665	16,092
Gross profit	99,835	100,898	75,274	56,250	26,953
Operating expenses:					
Marketing and selling	45,209	40,093	28,202	21,944	11,396
Research and development	16,676	15,576	15,645	10,604	4,318
General and administrative	23,133	19,746	15,214	11,004	5,806
Acquired in-process research and development[(ii)]			300	9,800	
Total operating expense	85,018	75,415	59,361	53,352	21,520
Income from operations	14,817	25,483	15,913	2,898	5,433
Other income, net	1,750	2,142	101	225	1,228
Income before provision for income taxes	16,567	27,625	16,014	3,123	6,661
Provision for income tax expense	5,488	10,152	6,234	4,050	509
Net income (loss)	$ 11,079	$ 17,473	$ 9,780	$ (927)	$ 6,152
Earnings (loss) per share:					
Basic	$ 0.40	$ 0.69	$ 0.45	$ (0.05)	$ 0.35
Diluted	$ 0.39	$ 0.66	$ 0.43	$ (0.05)	$ 0.33
Weighted average shares used in the calculation of earnings (loss) per share:					
Basic	27,651	25,278	21,600	19,548	17,429
Diluted	28,476	26,557	22,815	19,548	18,693

	December 31,				
	2009	2008	2007	2006	2005
	(in thousands)				
Balance Sheet Data:					
Cash, cash equivalents, and short-term investments	$ 33,551	$ 56,915	$ 11,916	$ 15,392	$ 52,209
Working capital	74,968	102,336	19,162	30,803	57,495
Total assets	291,491	258,622	189,571	124,163	77,395
Long-term debt (including current portion)	1,109	1,288	36,816		
Total stockholders equity	243,156	226,494	115,718	101,026	68,965

(i) Results of operations of the business we have acquired are included from their acquisition dates as follows: Fischer-Zoth in September 2004, Bio-logic in January 2006, Deltamed in September 2006, Olympic in October 2006, Xltek in November 2007, Sonamed in May 2008, Schwarzer Neurology in July 2008, Neurocom in October 2008, Hawaii Medical in July 2009, and Alpine Biomed in September 2009.

(ii) Acquired in-process research and development charges in 2007 are associated with our acquisition of Xltek, and in 2006 with our acquisitions of Bio-logic and Olympic.

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ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with our financial statements and the accompanying footnotes. MD&A includes the following sections:

Our Business. A general description of our business.

Year 2009 Overview. A summary of key information concerning the financial results for 2009 and changes from 2008.

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 critical judgments and estimates.

Results of Operations. An analysis of our results of operations for the three years presented in the financial statements.

Liquidity and Capital Resources. An analysis of capital resources, sources and uses of cash, investing and financing activities, and contractual obligations.

Quantitative and Qualitative Disclosures about Market Risk. A summary of currency exchange issues and interest rate hedging.

Off-Balance Sheet Arrangements. An analysis of off-balance sheet arrangements.

Recent Accounting Pronouncements. A recap of recently issued accounting pronouncements that may have an impact on our results of operations, financial position or cash flows.

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 neonatology, as well as newborn care products such as hearing screening systems, phototherapy devices for the treatment of newborn jaundice, head-cooling products for the treatment of brain injury in newborns, 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. Our significant acquisitions are as follows: Neometrics in 2003; Fischer-Zoth in 2004; Bio-logic, Deltamed, and Olympic in 2006; Xltek in 2007; Sonamed, Schwarzer Neurology, and Neurocom in 2008; and Hawaii Medical and Alpine Biomed in 2009.

Year 2009 Overview

During 2009, we continued to face challenging industry conditions as the global economic downturn in many parts of the world continued to impact business confidence. For the year, revenue declined across most of our business units. The growth that we did experience in 2009 was attributable to acquisitions completed during the year, as further discussed below. Despite these challenges, we generated strong cash flow from operations in 2009 and exited the year with $33 million of cash and only $1 million of long-term debt tied to our real estate.

In light of the uncertain economic conditions prevailing as we entered 2009, we took a more cautious approach in evaluating potential acquisition candidates, and did not resume acquisition activity until the second half of 2009.

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We acquired Hawaii Medical in July for $2.9 million in cash. Massachusetts based Hawaii Medical manufactures and markets single-use disposable products sold into the NICU and nursery in hospitals.

We acquired Alpine Biomed in September 2009 for $43.2 million in cash. Alpine Biomed, with corporate headquarters in Fountain Valley, California and manufacturing facilities in Montreal, Canada, and Copenhagen, Denmark, is a leader in the development, manufacturing, and sales of devices for the diagnosis of neurological disorders. Alpine Biomed s broad range of products includes advanced electromyography systems for the diagnoses of peripheral nervous system dysfunctions as well as devices for routine EEG and long term epilepsy monitoring.

Market conditions in our target markets appeared to improve in the latter half of 2009. However, we do not believe that our markets have yet returned to the level of activity that prevailed prior to the commencement of the credit crisis in the third quarter of 2008 that precipitated the global economic crisis. As a result of cost containment and other measures we have implemented, and our recent acquisitions, we believe that we will be well-positioned to capitalize on improving market conditions as, and to the extent, that such conditions develop.

Application of Critical Accounting Policies

We prepare our financial statements in accordance with accounting principles generally accepted in the United Sates 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, and 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

We recognize revenue, net of discounts, from sales of medical devices and supplies, including sales to distributors, when a purchase order has been received, when title transfers, when the selling price is fixed or determinable, and when collection of the resulting receivable is reasonably assured. Terms of sale for most domestic sales are FOB origin, reflecting that title and risk of loss are assumed by the purchaser at the shipping point, however, terms of sale for some neurology and sleep-diagnostic systems are FOB destination, reflecting that title and risk of loss are assumed by the purchaser upon delivery. Terms of sales to international distributors are EXW, reflecting that goods are shipped ex works, in which title and risk of loss are assumed by our distributor at the shipping point.

Revenue from sales of certain of our diagnostic neurology and hearing systems is recognized in accordance with Financial Accounting Standards Board (FASB) ASC 450-10-60, *Software Revenue Recognition*, wherein revenue is recognized when there is persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable, and collection is probable. For arrangements with multiple deliverables, revenue is allocated to the deliverables based on vendor specific objective evidence. For products shipped under FOB origin or EXW terms, delivery is generally considered to have occurred when shipped. Undelivered elements in our sales arrangements, which are not considered to be essential to the functionality of a product, generally include installation or training services that are performed after the related products have been delivered. Revenue related to undelivered installation services is deferred until such time as installation is complete at the customer s site. Revenue related to training services is recognized when such services are provided. Fair value for installation or training services are based on the price charged as if the services were sold separately. The fair value of installation and training services is based upon billable hourly rates and the estimated time to complete the service.

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Revenue from extended service and maintenance agreements, for both medical devices and data management systems, is recognized ratably over the service period. Freight charges billed to customers are included in revenue and freight-related expenses are charged to cost of revenue. Advance payments from customers are recorded as deferred revenue and recognized as revenue as otherwise described above. We generally do not provide rights of return on products. We accept trade-ins of our own and competitive medical devices. Trade-ins are recorded as a reduction of the replacement medical device sale. Provisions are made for initial standard warranty obligations of one year, and post-sale training and customer support at the time the related revenue is recognized. Negotiated pricing and discounts for sales subject to GPO contract terms are recognized as a reduction of the selling price of our products.

Allowance for doubtful accounts

We must exercise judgment when assessing the sufficiency of our allowance for estimated uncollectible accounts receivable. Our estimates are based on our historical collection experience within the markets in which we operate and any other specific information of which we may be aware, such as bankruptcy filings or liquidity problems of our customers. Based on the results of our analyses, activity associated with our provision for doubtful accounts has historically been within our expectations. Any future determination that our allowance for estimated uncollectible accounts receivable is not properly stated could result in a change in our operating expenses and results of operations.

Inventory is carried at the lower of cost or market value

We may be exposed to a number of factors that could result in portions of our inventory becoming either obsolete or being held in quantities that exceed anticipated usage. These factors include, but are not limited to: technological changes in our markets, competitive pressures in products and prices, and our own introduction of new product lines.

We regularly evaluate our ability to realize the value of our inventory based on a combination of factors, including historical usage rates, forecasted sales, product life cycles, and market acceptance of new products. When we identify inventory that is obsolete or in excess of anticipated usage we write it down to realizable salvage value. The estimates we use in projecting future product demand may prove to be incorrect. Any future determination that our inventory is overvalued could result in increases to our cost of sales and decreases to our operating margins and results of operations.

Carrying value of intangible assets and goodwill

We amortize intangible assets with finite lives over their useful lives; any future changes that would limit their useful lives or any determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges. We carry goodwill and any other intangible assets with indefinite lives at original cost but do not amortize them. Any future determination that these assets are carried at amounts greater than their estimated fair value could result in additional charges, which could significantly impact our operating results.

We test our definite-lived intangible assets for impairment whenever changes in circumstances indicate the carrying value of these assets may be impaired. Impairment indicators include, but are not limited to, net book value as compared to market capitalization, significant negative industry and economic trends, and significant underperformance relative to historical and projected future operating results. Impairment is considered to have occurred when the estimated undiscounted future cash flows related to the asset are less than its carrying value. Estimates of future cash flows involve consideration of many factors including the marketability of new products, product acceptance and lifecycle, competition, appropriate discount rates, and operating margins.

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually as of October 1st; this assessment is also performed whenever there is a change in circumstances that indicates the carrying value of

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these assets may be impaired. The determination of whether any potential impairment of goodwill exists is based upon a two step process. In the first analysis, the fair value of the reporting unit is compared to the unit s fair value, including goodwill, to determine if there is a potential impairment. If the fair value exceeds the carrying amount, the goodwill of the reporting unit is considered not impaired and no further analysis or action is required. If the first analysis indicates that the carrying value exceeds the fair value, a second analysis is performed to determine the amount of the goodwill impairment loss, if any.

In step two of the impairment test, the implied fair value of a reporting unit s goodwill is compared to the carrying amount of that goodwill. The implied fair value of the goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, the entity shall allocate the fair value of a reporting unit to all the assets and liabilities of that reporting unit, including unrecognized intangible assets as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of that goodwill.

To determine the estimated fair value of reporting units, three valuation methodologies are utilized: (i) discounted cash flow analyses, (ii) market multiples, and (iii) comparative transactions. The valuations indicated by these three methodologies are averaged, with the greatest weight placed on discounted cash flow analyses. Discounted cash flow analyses are dependent upon a number of quantitative and qualitative factors including estimates of forecasted revenue, profitability, earnings before interest, taxes, depreciation and amortization (i.e. EBITDA) and terminal values. The discount rates applied in the discounted cash flow analyses also have an impact on the estimates of fair value, as use of a higher rate will result in a lower estimate of fair value. The estimated total fair value of reporting units is reconciled to the Company s market capitalization.

Liability for product warranties

Our medical device products are covered by standard one-year product warranty plans. A liability has been established for the expected cost of servicing our medical device products during these service periods. We base the liability on actual warranty costs incurred to service those products. On new products, additions to the reserve are based on a combination of factors including the percentage of service department labor applied to warranty repairs, as well as actual service department costs and other judgments, such as the degree to which the product incorporates new technology applied to the number of units sold. As warranty costs are incurred, the reserve is reduced.

The estimates we use in projecting future product warranty costs may prove to be incorrect. Any future determination that our product warranty reserves are understated could result in increases to our cost of sales and reductions in our operating profits and results of operations.

Share-based compensation

We record the fair value of share-based compensation awards as expenses in the consolidated statement of operations. In order to determine the fair value of stock options on the date of grant, we apply the Black-Scholes option-pricing model. Inherent in this model are assumptions related to expected dividend yield, risk-free interest rate, expected stock-price volatility, expected term, and forfeiture rate. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, expected stock-price volatility, expected life, and forfeiture rate assumptions require a greater level of judgment which makes them critical accounting estimates. If we used different assumptions, we would have recorded different amounts of share-based compensation.

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Results of Operations

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

	Percent of Revenue Years Ended December 31,		
	2009	2008	2007
Revenue	100.0%	100.0%	100.0%
Cost of revenue	40.0	37.7	36.4
Gross profit	60.0	62.3	63.6
Operating expenses:			
Marketing and selling	27.2	24.7	23.8
Research and development	10.0	9.6	13.2
General and administrative	13.9	12.2	12.8
Acquired in-process research and development			0.3
Total operating expenses	51.1	46.5	50.1
Income from operations	8.9	15.8	13.5
Other income, net	1.1	1.3	0 .1
Income before provision for income tax	10.0	17.1	13.6
Income tax provision	3.3	6.3	5.3
Net income	6.7%	10.8%	8.3%

Acquisitions

We completed six significant acquisitions during 2009, 2008 and 2007, and the timing of these acquisitions had an impact on the comparison of our results of operations for the years ended December 31, 2009, 2008 and 2007.

Alpine Biomed Completed on September 14, 2009. Alpine Biomed reported revenue from its neurology business of approximately $38.1 million during its last completed fiscal year prior to the acquisition.

Hawaii Medical Completed on July 2, 2009. Hawaii Medical reported revenue of approximately $3.2 million during its last completed fiscal year prior to the acquisition.

Neurocom Completed on October 2, 2008. Neurocom reported revenue of approximately $11.4 million during its last completed fiscal year prior to the acquisition.

Schwarzer Neurology Completed on July 2, 2008. Schwarzer Neurology reported revenue of approximately $7.1 million during its last completed fiscal year prior to the acquisition.

Sonamed Completed on May 27, 2008. Sonamed reported revenue of approximately $3.5 million during its last completed fiscal year prior to the acquisition.

Xltek Completed on November 29, 2007. Xltek reported revenue of approximately $26.7 million during its last completed fiscal year prior to the acquisition.

The pre-acquisition revenue of our acquired companies may not be indicative of their contribution to revenue in the future.

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Comparison of 2009 and 2008

Operating Results

We analyze our revenue from two perspectives. Because our acquisitions have been significant, we measure the contribution to consolidated revenue of the businesses we acquire. We also analyze our revenue as coming from two sources: devices and systems, and supplies and services. We report freight revenue separate from these two sources.

Our revenue increased 2.9%, or $4.7 million, to $166.5 million in 2009, from $161.8 million in 2008. Alpine Biomed, Neurocom and Schwarzer Neurology contributed $17.4 million to this increase in our revenue in 2009. This was offset by a $12.2 million net decrease in equipment sales across the Company s other product lines, resulting from a weakness in demand that we believe was due to the economic recession during 2009.

Revenue from devices and systems was $96.2 million in 2009, representing a decrease of 6% or $6.3 million, from $102.5 million reported in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to $12.1 million of the increase in revenue from devices and systems offset by a $6.8 million decrease in hearing revenue, a $5.3 million decrease in neurology revenue, and a $3.1 million decrease in newborn care revenue. Revenue from supplies and services was $67.1 million in 2009, representing an increase of 18%, or $10.6 million, from $56.7 million in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to $5.1 million of the increase. Hearing supplies increased by $1.3 million and newborn care supplies increased by $2.0 million.

Revenue from devices and systems was 58% of consolidated revenue in 2009 compared to 63% of total revenue in 2008, and revenue from supplies and services was 40% of total revenue in 2009 compared to 35% of revenue in 2008. Freight revenue of $3.2 million in 2009 and $2.7 million in 2008 represented 2% of total revenue in both periods.

No customer accounted for more than 10% of our revenue in either 2009 or 2008. Revenue from domestic sales decreased 3% to $109.7 million in 2009, from $112.6 million in 2008. Revenue from international sales increased 15% to $56.8 million in 2009, compared to $49.2 million in 2008. Revenue from domestic sales was 66% of total revenue in 2009, compared to 70% in 2008, and revenue from international sales was 34% of total revenue in 2009 compared to 30% of revenue in 2008. The changes in the percentages from 2009 to 2008 resulted primarily from the contribution of Alpine Biomed, whose sales are primarily in Europe.

Our cost of revenue increased $5.7 million, or 9%, to $66.7 million in 2009, from $60.9 million in 2008. The increase was primarily due to our increased sales and higher materials costs. Gross profit decreased $1.1 million, or 1%, to $99.8 million in 2009 from $100.9 million in 2008. Gross profit as a percentage of revenue was 60% in 2009 compared to 62% in 2008. The decline in gross profit as a percentage of sales was due in part to the Alpine Biomed products having a lower gross margin than our existing products. In addition, the gross profit percentage of our European operations, excluding Alpine, was approximately 50% for 2009 compared to approximately 59% for 2008, due primarily to the impact that a lower revenue base had on manufacturing overhead as a percentage of revenue, as this cost is largely fixed.

Total operating costs increased $9.6 million, or 13%, to $85.0 million in 2009, from $75.4 million in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to $12.5 million of the increase in operating costs partially offset by a $2.8 million decrease in operating costs in our North American divisions resulting from restructuring activities initiated in early 2008 that were substantially completed in that year. Our operating costs increased as a percentage of revenue from 47% in 2008 to 51% in 2009.

Our marketing and selling expenses increased $5.1 million, or 13%, to $45.2 million in 2009, from $40.1 million in 2008. The operations of Alpine Biomed, Neurocom and Schwarzer Neurology contributed to $6.7 million of the increase offset by a decrease of $1.2 million in sales compensation costs resulting from decreased direct sales of devices. Marketing and selling expenses as a percent of total revenue increased from 24.8% in 2008 to 27.2% in 2009.

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Our research and development expenses increased $1.1 million, or 7%, to $16.7 million in 2009 from $15.6 million in 2008. The operations of Alpine Biomed, Neurocom, and Schwarzer Neurology contributed to $2.2 million of research and development expense, partially offset by reduced costs resulting from restructuring activities implemented in February 2008 for which we did not receive a benefit until late in 2008 and continuing into 2009. Research and development expenses as a percent of total revenue increased from 9.6% in 2008 to 10.0% in 2009.

Our general and administrative expenses increased $3.4 million, or 17%, to $23.1 million in 2009 from $19.7 million in 2008. General and administrative expenses as a percent of revenue increased from 12.2% in 2008 to 13.9% in 2009. General and administrative expenses of Alpine Biomed, Neurocom and Schwarzer Neurology represented $3.6 million of the increase. Direct costs of acquisitions completed in 2009 totaled $460,000 and were reported as a component of general and administrative expense; we had no similar costs in 2008 under prior accounting rules. General and administrative expenses other than those mentioned above were approximately $560,000 lower in 2009 compared to 2008.

Other income, net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported other income, net of $1.7 million in 2009, compared to $2.1 million in 2008. Investment income of $228,000 in 2009 was $801,000 less than the amount reported for 2008 reflecting lower interest rates and a lower investment portfolio due to our recent acquisitions. Net foreign currency exchange gains reported in 2009 were $1.1 million less than the amount reported for 2008. We reported $582,000 less in interest expense in 2009 compared to 2008 due primarily to lower outstanding balances on our credit facilities. In 2009 we also recorded a $650,000 adjustment to the value of a contingent liability associated with the acquisition of Alpine Biomed that resulted in an increase to other income for which there was no similar item in 2008.

We recorded income tax expense of $5.5 million in 2009, compared to $10.2 million recorded in 2008. Our effective tax rate for 2009 decreased to 33.1% compared to 36.7% in 2008 because more of our income was taxed in foreign jurisdictions with tax rates lower than in the U.S. At December 31, 2009, we had federal net operating loss carryforwards of approximately $8.2 million available to offset future taxable income. Income tax expense related to our international operations is based on the statutory rates in those jurisdictions.

On January 13, 2010 we announced that we had adopted a reorganization plan that is designed to eliminate redundant costs resulting from the acquisition of Alpine Biomed for which we expect to record a restructuring charge approximately $2.5 million in the first quarter of 2010.

Comparison of 2008 and 2007

Operating Results

Our revenue increased 37%, or $43.4 million, to $161.8 million in 2008, from $118.4 million in 2007. NeuroCom, Sonamed and Schwarzer Neurology contributed $8.8 million to our revenue in 2008. In 2008, Xltek contributed $35.3 million of the increase.

Revenue from devices and systems was $102.5 million in 2008, representing an increase of 40% or $29.3 million, from $73.2 million reported in 2007. The operations of Xltek, Sonamed, Schwarzer Neurology and Neurocom contributed to $33.9 million of this increase, offset by a decrease in Bio-logic neurology and Fischer-Zoth hearing sales. Revenue from supplies and services was $56.7 million in 2008, representing an increase of 30%, or $13.1 million, from $43.6 million in 2007. The operations of Xltek, Sonamed, Schwarzer Neurology and Neurocom contributed to $9.7 million of the increase.

Revenue from devices and systems was 63% of total revenue in 2008 compared to 62% of total revenue in 2007, and revenue from supplies and services was 35% of total revenue in 2008 compared to 37% of revenue in 2007. The changes in the percentages from 2007 to 2008 resulted primarily from the contribution of a full year of

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operations from Xltek, whose mix of sales includes more devices without supplies than our other product lines. Freight revenue of $2.7 million in 2008 represented 2% of total revenue, while freight revenue of $1.6 million in 2007 represented 1% of total revenue.

No customer accounted for more than 10% of our revenue in either 2008 or 2007. Revenue from domestic sales increased 43% to $113.0 million in 2008, from $78.9 million in 2007. Revenue from international sales increased 25% to $49.2 million in 2008, compared to $39.5 million in 2007. Revenue from domestic sales was 70% of total revenue in 2008, compared to 67% in 2007, and revenue from international sales was 30% of total revenue in 2008 compared to 33% of revenue in 2007. The changes in the percentages from 2007 to 2008 resulted primarily from the contribution of Xltek, whose sales are primarily based in the U.S.

Our cost of revenue increased $17.8 million, or 41%, to $60.9 million in 2008, from $43.1 million in 2007. The increase was primarily due to our increased sales, and also includes $364,000 of share-based compensation expense in 2008 compared to $175,000 in 2007. Gross profit increased $25.6 million, or 34%, to $100.9 million in 2008 from $75.3 million in 2007, primarily due to our increased sales. Gross profit as a percentage of revenue was 62% in 2008 compared to 64% in 2007. The gross profit of Xltek was approximately 50 percent at the time we acquired the business in November 2007. While Xltek s gross profit improved to approximately 62 percent by the fourth quarter of 2008, the reduction in gross profit on a consolidated basis from 2007 to 2008 was largely attributable to Xltek.

Total operating costs increased $16.0 million, or 27%, to $75.4 million in 2008, from $59.4 million in 2007. The operations of Xltek, Schwarzer Neurology and Neurocom and contributed to $13.2 million of the increase in operating costs. We also recorded $2.9 million of employee share-based compensation expense in 2008 compared to $1.9 million in 2007. Our operating costs declined as a percentage of revenue in 2008 to 46% from 50% in 2007 primarily from integration and restructuring designed to eliminate redundant costs.

Our marketing and selling expenses increased $11.9 million, or 42%, to $40.1 million in 2008, from $28.2 million in 2007. The operations of Xltek, Schwarzer Neurology and Neurocom contributed to $7.2 million of the increase. We recorded $802,000 of employee share-based compensation expense in marketing and selling expenses in 2008 compared to $509,000 in 2007, with the remainder of the cost increase coming primarily from increases in sales compensation and travel expenses resulting from higher sales.

Our research and development expenses decreased $69,000, or 0.4%, to $15.5 million in 2008 from $15.6 million in 2007. The operations of Xltek, Schwarzer Neurology and Neurocom contributed to $3.5 million of research and development expense, the impact of which was mitigated in part by restructuring activities we implemented in February 2008. Research and development expenses as a percent of total revenue decreased from 13% in 2007 to 10% in 2008. We recorded $377,000 of employee share-based compensation expense in research and development expenses in 2008, compared to $108,000 in 2007.

Our general and administrative expenses increased $4.5 million, or 30%, to $19.7 million in 2008 from $15.2 million in 2007. General and administrative expenses of Xltek, Schwarzer Neurology, and Neurocom represented $2.5 million of the increase. In addition we recorded $1.7 million of employee share-based compensation expense in general and administrative expenses in 2008 compared to $1.3 million for 2007, with higher compensation, insurance, and outside services costs contributing to the remainder of the cost increases.

Other income, net consists of investment income, interest expense, net currency exchange gains and losses, and other miscellaneous income and expense. We reported net other income of $2.1 million in 2008, compared to $101,000 in 2007 due primarily to net currency exchange gains. Unrealized exchange gains and losses from our consolidated foreign subsidiaries are not included in net income, but are reported as a component of other comprehensive income. In connection with the acquisition of Xltek, in mid October 2007 we entered into a forward contract for the purchase of CAD $50 million. This contract was executed on November 27, 2007, and resulted in a currency hedging loss of approximately $480,000 in the fourth quarter of 2007. During the two days

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between the execution of the contract and the funding of the acquisition, we incurred an additional currency loss of $250,000, also in the fourth quarter of 2007. We did not enter into any other significant hedging activities in 2008 or 2007.

We recorded income tax expense of $10.2 million in 2008, compared to $6.2 million recorded in 2007. Our effective tax rate for 2008 decreased to 36.7% compared to 38.9% in 2007 because more of our income was taxed in foreign jurisdictions with tax rates lower than in the U.S. At December 31, 2008, we had federal net operating loss carryforwards of approximately $2.7 million available to offset future taxable income. Income tax expense related to our international operations is based on the statutory rates in those jurisdictions.

Liquidity and Capital Resources

Comparison of 2009 and 2008

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 and 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 these resources in meeting our commitments and in achieving our business objectives.

As of December 31, 2009, we had cash, cash equivalents, and short-term investments of $33.5 million, stockholders equity of $243.2 million, and working capital of $75.0 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 and cash equivalents and any cash generated from operations will be sufficient to meet our ongoing operating and capital requirements for the foreseeable future. We completed two acquisitions in 2009 including Alpine Biomed at the end of the third quarter, four 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. In order to finance future acquisitions, 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.

We have a $25 million revolving credit facility with Wells Fargo Bank, National Association (Wells Fargo). The revolving 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. We did not draw on the facility during 2009. We have no other significant credit facilities.

Global capital markets have been, and may continue to be, disrupted and volatile. The cost and availability of equity and debt funding has been and may continue to be adversely affected by illiquid capital and credit markets. Some lenders have reduced or, in some cases, ceased to provide funding to borrowers. We believe that we have adequate liquidity to meet our present needs. Continued turbulence in the United States and international financial markets, however, could adversely affect the cost and availability of financing to us in the future and limit our ability to acquire products, other assets, or businesses.

Cash provided by operations increased by $14.8 million for the year ended December 31, 2009 to $26.6 million, compared to $11.8 million in 2008. The sum of our net income and certain non-cash expense items, such as reserves, depreciation and amortization, and share based compensation was approximately $24.2 million in 2009, compared to $26.9 million in 2008. The aggregate impact of changes in certain operating assets and

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liabilities was a cash inflow of $2.4 million in 2009 compared to a cash outflow of $15.1 million in 2008. In particular, while the carrying amounts of accounts receivable and inventory, exclusive of those items acquired in acquisitions, resulted in a use of cash of $10.3 million in 2008, they resulted in a source of cash of $662,000 in 2009.

Cash used in investing activities was $51.8 million for the year ended December 31, 2009, compared to $34.0 million in 2008. We used $2.6 million and $3.6 million of cash to acquire property and equipment, during the years ended December 31, 2009 and 2008, respectively. We used $47.2 million of cash to acquire businesses during the year ended December 31, 2009 compared with $29.0 million during the year ended December 31, 2008. During the year ended December 31, 2009 we recorded $1.0 million of internal use software development costs compared with $1.5 million in 2008. In addition, we purchased $965,000 of marketable securities in 2009 and purchased and sold $12.1 million of marketable securities during the year ended December 31, 2008.

Cash provided by financing activities was $489,000 in the year ended December 31, 2009, compared to $69.1 million in 2008. We raised an aggregate of $99.3 million through underwritten registered public offerings of our common stock in April and May 2008 with no similar transactions in 2009. We received cash from sales of our stock pursuant to our stock awards plans and our employee stock purchase plan in the amount of $1.1 million and $2.9 million in the year ended December 31, 2009 and 2008, respectively. In 2009 our after-tax cost of stock-based compensation was $159,000 more than the tax benefit we received from those arrangements, compared with an excess tax benefit of $2.2 million in 2008. These amounts were recorded as a decrease to stockholders equity in 2009 and as an increase to stockholders equity in 2008. We repaid $429,000 under term loan agreements in the year ended December 31, 2009. During the year ended December 31, 2008, we borrowed $6.0 million under our revolving line of credit and we repaid $25.2 million on our term loan agreements and $16.1 million on our revolving credit facility.

Comparison of 2008 and 2007

As of December 31, 2008, we had cash and cash equivalents of $56.9 million, stockholders equity of $226.4 million, and working capital of $102.3 million, compared with cash and cash equivalents of $11.9 million, stockholders equity of $115.7 million, and working capital of $19.2 million as of December 31, 2007.

Cash provided by operations increased by $864,000 for the year ended December 31, 2008 to $11.8 million, compared to $10.9 million in 2007. The sum of our net income and certain non-cash expense items, such as reserves, depreciation and amortization, and share based compensation was approximately $26.8 million in 2008, compared to $17.0 million in 2007. The aggregate impact of changes in certain operating assets and liabilities was a cash outflow of $15.1 million in 2008 compared to $6.1 million in 2007.

Cash used in investing activities was $34.0 million for the year ended December 31, 2008, compared to $52.7 million in 2007. We used $3.6 million and $2.1 million of cash to acquire property and equipment, during the years ended December 31, 2008 and 2007, respectively. We used $29.0 million of cash to acquire businesses during the year ended December 31, 2008 compared with $50.0 million during the year ended December 31, 2007. During the year ended December 31, 2008 we recorded $1.3 million of internal use software development costs compared with $649,000 in 2007. In addition, we purchased and sold $12.1 million of marketable securities during the year ended December 31, 2008 with no similar activities in 2007.

Cash provided by financing activities was $69.1 million in the year ended December 31, 2008, compared to $37.6 million in 2007. We raised an aggregate of $99.3 million through underwritten registered public offerings of our common stock in April and May 2008 with no similar transactions in 2007. We raised cash through sales of our stock pursuant to our stock awards plans and our employee stock purchase plan in the amount of $2.9 million and $2.0 million in the year ended December 31, 2008 and 2007, respectively. We also realized an excess tax benefit of $2.2 million on the exercise of employee stock options in 2008 compared to $598,000 in 2007; in both years this was recorded as an increase to stockholders equity. During the year ended December 31, 2008,

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we borrowed $6.0 million under our revolving line of credit and we repaid $25.2 million on our term loan and $16.1 million on our revolving credit facility. We had no similar uses of cash for financing activities in the year ended December 31, 2007.

Future Liquidity

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;
- 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.

Contractual Obligations

In the normal course of business, we enter into obligations and commitments that require future contractual payments. The commitments result primarily from firm, noncancellable purchase orders placed with contract vendors that manufacture some of the components used in our medical devices and related disposable supply products, as well as commitments for leased office equipment and term loans. The following table summarizes our contractual obligations and commercial commitments as of December 31, 2009 (in thousands):

		Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Unconditional purchase obligations	$ 18,054	$ 18,003	$ 51	$	$
Operating lease obligations	247	82	163	2	
Other contractual obligations	1,000		1,000		
Long-term liabilities (including interest)	1,301	257	551	493	
Total	$ 20,602	$ 18,342	$ 1,765	$ 495	$

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

We are not able to reasonably estimate the timing of any potential payments for uncertain tax positions under ASC 740, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109*. As a result, the preceding table excludes any potential future payments related to our ASC 740 liability for uncertain tax positions. See Note 14 of our consolidated financial statements for further discussion on income taxes.

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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.

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 year ended December 31, 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 of 10% in market interest rates would not result in a material decrease in interest income earned on investments held at December 31, 2009.

When able, we invest excess cash in bank money-market funds or discrete short-term investments. The fair value of our short-term investments and cash equivalents (investments) is sensitive to changes in the general level of interest rates in the U.S., and the fair value of these investments will fall if market interest rates increase. However, since we generally have the ability to hold the investments to maturity, these declines in fair value may never be realized. If market interest rates were to increase by 10% from levels at December 31, 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 December 31, 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.

Off-Balance Sheet Arrangements

Under our bylaws, we have agreed to indemnify our officers and directors for certain events or occurrences arising as a result of the officer or director s serving in such capacity. We have a directors and officers liability insurance policy that limits our exposure and enables us to recover a portion of any future amounts paid resulting from the indemnification of our officers and directors. In addition, we enter into indemnification agreements with other parties in the ordinary course of business. In some cases we have obtained liability insurance providing coverage that limits our exposure for these other indemnified matters. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. We believe the estimated fair value of these indemnification agreements is minimal and have not recorded a liability for these agreements as of December 31, 2009. We had no other off-balance sheet arrangements during any of fiscal 2009, 2008 or 2007 that had, or are reasonably likely to have, a material effect on our consolidated financial condition, results of operations, or liquidity.

Recent Accounting Pronouncements

See *Note 1 Organization and Significant Accounting Policies* to the Consolidated Financial Statements contained herein for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of our operations and financial condition.

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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 7 include, but are not limited to, statements regarding the following: our ability to capitalize on improving market conditions, 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, 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 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 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by this Item is set forth in the section entitled *Management s Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures About Market Risk,* and is incorporated by reference in this section.

ITEM 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements and Supplementary Data required by this Item are set forth where indicated in Item 15 of this report.

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Selected Quarterly Financial Data (Unaudited)

The following table presents our operating results for each of the eight quarters in the period ending December 31, 2009. The information for each of these quarters is unaudited and has been prepared on the same basis as our audited financial statements appearing elsewhere in this report. In the opinion of our management, all necessary adjustments, consisting only of normal recurring adjustments, have been included to present fairly the unaudited quarterly results when read in conjunction with our audited consolidated financial statements and the related notes appearing elsewhere in this report. These operating results are not necessarily indicative of the results of any future period.

	Quarters Ended							
	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	March 31, 2009	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	March 31, 2008
	(in thousands)							
Revenue	$ 51,634	$ 44,251	$ 37,263	$ 33,357	$ 43,396	$ 41,714	$ 39,862	$ 36,859
Cost of revenue	21,801	17,450	14,370	13,049	15,719	15,835	15,374	14,005
Gross profit	29,833	26,801	22,893	20,308	27,677	25,879	24,488	22,854
Gross profit percentage	57.8%	60.6%	61.4%	60.9%	63.8%	62.0%	61.4%	62.0%
Operating expenses:								
Marketing and selling	13,204	11,767	10,251	9,987	11,072	9,965	9,180	9,876
Research and development	4,837	4,175	3,950	3,714	3,615	4,066	4,068	3,827
General and administrative	6,671	5,688	5,270	5,504	4,537	4,913	5,440	4,856
Total operating expenses	24,712	21,630	19,471	19,205	19,224	18,944	18,688	18,559
Income from operations	5,121	5,171	3,422	1,103	8,453	6,935	5,800	4,295
Other income, net	1,166	71	387	126	1,188	567	386	1
Income before provision for income tax	6,287	5,242	3,809	1,229	9,641	7,502	6,186	4,296
Provision for income tax	2,000	1,573	1,473	442	3,354	2,710	2,419	1,669
Net income	$ 4,287	$ 3,669	$ 2,336	$ 787	$ 6,287	$ 4,792	$ 3,767	$ 2,627
Earnings per share:								
Basic	$ 0.15	$ 0.14	$ 0.08	$ 0.03	$ 0.23	$ 0.17	$ 0.16	$ 0.12
Diluted	$ 0.15	$ 0.13	$ 0.08	$ 0.03	$ 0.22	$ 0.17	$ 0.15	$ 0.11