

SeaSpine Holdings Corp
Form 10-Q
November 06, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

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 NO. 001-36905

SeaSpine Holdings Corporation
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

47-3251758
(I.R.S. EMPLOYER IDENTIFICATION NO.)

5770 Armada Drive, Carlsbad, California 92008
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (760) 727-8399

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

The number of shares of the registrant's common stock, \$0.01 par value, outstanding as of October 30, 2018 was 18,532,759.

SEASPINE HOLDINGS CORPORATION
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SEASPINE HOLDINGS CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (Unaudited)
 (In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total revenue, net	\$35,834	\$31,742	\$105,418	\$97,832
Cost of goods sold	14,247	12,176	40,986	39,342
Gross profit	21,587	19,566	64,432	58,490
Operating expenses:				
Selling, general and administrative	27,041	23,674	76,940	71,893
Research and development	3,203	2,834	8,783	9,228
Intangible amortization	792	792	2,376	2,376
Total operating expenses	31,036	27,300	88,099	83,497
Operating loss	(9,449)	(7,734)	(23,667)	(25,007)
Other (expense) income, net	(190)	215	(327)	387
Loss before income taxes	(9,639)	(7,519)	(23,994)	(24,620)
(Benefit) provision for income taxes	(107)	(57)	4	(12)
Net loss	\$(9,532)	\$(7,462)	\$(23,998)	\$(24,608)
Net loss per share, basic and diluted	\$(0.65)	\$(0.58)	\$(1.66)	\$(2.04)
Weighted average shares used to compute basic and diluted net loss per share	14,750	12,815	14,477	12,079

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

SEASPINE HOLDINGS CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
 (Unaudited)
 (In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	\$(9,532)	\$(7,462)	\$(23,998)	\$(24,608)
Other comprehensive (loss) income				
Foreign currency translation adjustments	(57)	166	(238)	567
Comprehensive loss	\$(9,589)	\$(7,296)	\$(24,236)	\$(24,041)

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

SEASPIKE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par value data)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,782	\$ 10,788
Trade accounts receivable, net of allowances of \$451 and \$466	20,673	21,872
Inventories	42,942	41,721
Prepaid expenses and other current assets	2,654	2,037
Total current assets	78,051	76,418
Property, plant and equipment, net	22,949	22,063
Intangible assets, net	30,336	35,207
Other assets	1,033	786
Total assets	\$ 132,369	\$ 134,474
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	10,626	7,385
Accrued compensation	6,525	5,833
Accrued commissions	4,760	5,793
Contingent consideration liabilities	793	207
Other accrued expenses and current liabilities	4,077	3,939
Total current liabilities	26,781	23,157
Long-term borrowings under credit facility	7,262	—
Contingent consideration liabilities	2,636	4,228
Other liabilities	1,476	1,436
Total liabilities	38,155	28,821
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 15,000 authorized; no shares issued and outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock, \$0.01 par value; 60,000 authorized; 14,792 and 13,508 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	148	135
Additional paid-in capital	219,628	206,844
Accumulated other comprehensive income	1,712	1,950
Accumulated deficit	(127,274)	(103,276)
Total stockholders' equity	94,214	105,653
Total liabilities and stockholders' equity	\$ 132,369	\$ 134,474

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

SEASPINE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES:		
Net loss	\$(23,998)	\$(24,608)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,950	8,184
Instrument replacement expense	1,269	1,146
Provision for excess and obsolete inventories	2,940	3,229
Amortization of debt issuance costs	94	104
Deferred income tax provision	36	103
Stock-based compensation	3,449	4,505
Gain from change in fair value of contingent consideration liabilities	(893)	(897)
Changes in assets and liabilities:		
Accounts receivable	1,069	1,405
Inventories	(3,446)	1,814
Prepaid expenses and other current assets	(622)	(653)
Other non-current assets	(218)	(11)
Accounts payable	3,763	(1,160)
Accrued commissions	(1,032)	166
Other accrued expenses and current liabilities	898	2,600
Other non-current liabilities	140	(36)
Net cash used in operating activities	(8,601)	(4,109)
INVESTING ACTIVITIES:		
Purchases of property and equipment	(6,565)	(5,518)
Additions to technology assets	—	(200)
Net cash used in investing activities	(6,565)	(5,718)
FINANCING ACTIVITIES:		
Borrowings under credit facility	7,000	—
Repayments of credit facility	—	(4,020)
Repayments of short-term debt	—	(445)
Proceeds from issuance of common stock, net of offering costs- ATM transactions	8,514	15,557
Proceeds from issuance of common stock- employee stock purchase plan	546	453
Proceeds from exercise of stock options	886	35
Repurchases of common stock for income tax withheld upon vesting of restricted stock awards and restricted stock units	(600)	(48)
Payment of contingent consideration liabilities in connection with acquisition of business	(113)	—
Net cash provided by financing activities	16,233	11,532
Effect of exchange rate changes on cash and cash equivalents	(73)	418
Net change in cash and cash equivalents	994	2,123
Cash and cash equivalents at beginning of period	10,788	14,566
Cash and cash equivalents at end of period	\$11,782	\$16,689
Supplemental disclosures of cash flow information:		

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Cash paid for interest	\$109	\$287
Non-cash operating activities:		
Settlement of bonus in payment of restricted stock units	\$—	\$970
Non-cash investing activities:		
Property and equipment in liabilities	\$538	\$972

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

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SEASPIKE HOLDINGS CORPORATION
 CONDENSED CONSOLIDATED STATEMENT OF EQUITY
 (Unaudited)
 (In thousands)

	Common Stock		Additional	Accumulated		Total
	Number	Amount	Paid-In	Other	Accumulated	Stockholders'
	of		Capital	Comprehensive	Deficit	Equity
	Shares			Income		
Balance December 31, 2017	13,508	\$ 135	\$206,844	\$ 1,950	\$(103,276)	\$ 105,653
Net loss	—	—	—	—	(23,998)	(23,998)
Foreign currency translation adjustment	—	—	—	(238)	—	(238)
Issuance of common stock upon vesting of restricted stock units	256	3	(1)	—	—	2
Issuance of common stock under employee stock purchase plan	81	1	545	—	—	546
Issuance of common stock, net of offering costs- ATM transactions	882	9	8,505	—	—	8,514
Issuance of common stock- exercise of stock options	67	—	886	—	—	886
Repurchases of common stock for income tax withheld upon vesting of restricted stock awards and restricted stock units	(2)	—	(600)	—	—	(600)
Stock-based compensation	—	—	3,449	—	—	3,449
Balance September 30, 2018	14,792	\$ 148	\$219,628	\$ 1,712	\$(127,274)	\$ 94,214

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

SEASPINE HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND BASIS OF PRESENTATION

Business

SeaSpine Holdings Corporation was incorporated in Delaware on February 12, 2015 in connection with the spin-off of the orthobiologics and spinal implant business of Integra LifeSciences Holdings Corporation, a diversified medical technology company. The spin-off occurred on July 1, 2015. Unless the context indicates otherwise, (i) references to "SeaSpine" or the "Company" refer to SeaSpine Holdings Corporation and its wholly-owned subsidiaries, and (ii) references to "Integra" refer to Integra LifeSciences Holdings Corporation and its subsidiaries other than SeaSpine.

Basis of Presentation and Principles of Consolidation

The Company prepared the unaudited interim condensed consolidated financial statements included in this report in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC) related to quarterly reports on Form 10-Q.

The Company's financial statements are presented on a consolidated basis. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation. The unaudited interim condensed consolidated financial statements do not include all information and disclosures required by GAAP for annual audited financial statements and should be read with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2017 included in the Company's Annual Report on Form 10-K filed with the SEC. In the opinion of management, the unaudited interim condensed consolidated financial statements included in this report have been prepared on the same basis as the Company's audited consolidated financial statements and include all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations, cash flows, and statement of equity for periods presented. The results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results expected for the full year. The condensed consolidated balance sheet as of December 31, 2017 was derived from the audited consolidated financial statements for the year ended December 31, 2017.

Concentration of Risk

Integra and PcoMed, LLC (PcoMed) entered into a Supply Agreement on May 15, 2013 (Supply Agreement), which was subsequently assigned to the Company by Integra on May 21, 2015. For the quarter ending September 30, 2018, the sales of products incorporating the technology licensed and supplied to the Company pursuant to the Supply Agreement exceeded 10% of the Company's revenue.

Pursuant to the Supply Agreement, PcoMed granted the Company a worldwide exclusive license to sell certain of its products treated with certain proprietary PcoMed technology (Treatment) for use in the spinal interbody and intervertebral market (Treated Products). PcoMed serves as the sole supplier of the Treatment. As consideration for the license and the Treatment, the Company paid to PcoMed initial milestone payments prior to the initial sale and the Company will pay PcoMed a low single digit royalty on the Company's net sales of all Treated Products. In the event the Company fails to meet any of its payment obligations, the license will, at PcoMed's option and following a cure period, convert to a non-exclusive license. The Supply Agreement contains customary representations and termination provisions, including for material breach and bankruptcy. Each of the Company and PcoMed retain the rights to their respective intellectual property.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

Preparing consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Significant estimates affecting amounts reported or disclosed in the consolidated financial statements include allowances for doubtful accounts receivable and sales returns and other credits, net realizable value of inventories, discount rates and estimated projected cash flows used to value and test impairments of identifiable intangible and

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SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

long-lived assets, assumptions related to the timing and probability of product launch dates, discount rates matched to the estimated timing of payments, probability of success rates and discount adjustments on the related cash flows for contingent considerations in business combinations, depreciation and amortization periods for identifiable intangible and long-lived assets, computation of taxes, valuation allowances recorded against deferred tax assets, the valuation of stock-based compensation and loss contingencies. These estimates are based on historical experience and on various other assumptions believed to be reasonable under the current circumstances. Actual results could differ from these estimates.

Recent Accounting Standards Not Yet Adopted

The Company qualifies as an “emerging growth company” (EGC) under the Jumpstart Our Business Startups (JOBS) Act and elected to take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, which permits EGCs to defer compliance with new or revised accounting standards (the EGC extension) until non-issuers must comply with such standards. Accordingly, so long as the Company continues to qualify as an EGC, the Company will not have to adopt or comply with new or revised accounting standards until non-issuers must adopt or comply with such standards.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU or Update) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard provides a five-step approach to be applied to all contracts with customers. The new standard also requires expanded disclosure about revenue recognition. The new standard as amended by ASU 2015-14, ASU 2016-10 and ASU 2016-12, will be effective for the Company beginning on January 1, 2019. The Company performed a preliminary assessment of the impact of this new standard on its consolidated financial statements. In assessing the impact, the Company has outlined all revenue streams, and has considered the five steps outlined in the standard for product sales, from which substantially all the Company's revenue is generated. The Company is analyzing the impact of this new standard on all revenue streams and on all contracts with customers, including by reviewing contracts and current accounting policies and practices to identify potential differences that would result from applying the requirements under the new standard. The Company plans to adopt the new standard using the modified retrospective method. The Company will continue to evaluate the future impact of the new standard throughout 2018.

In February 2016, the FASB issued Update No. 2016-02, Leases (Topic 842). The new standard requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than twelve months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new standard must be adopted using the modified retrospective approach. The standard will be effective for the Company beginning on January 1, 2020 with early adoption permitted. The Company does not plan to early adopt and expects to apply the transition practical expedients allowed by the standard. In July 2018, the FASB issued Update No. 2018-10, Codification Improvements to Topic 842 (Leases) and Update No. 2018-11, Leases (Topic 842): Targeted Improvements. The amendments in ASU 2018-10 and ASU 2018-11 provide additional clarification and implementation guidance on certain aspects of the previously issued ASU 2016-02 and have the same effective date and transition requirements as ASU 2016-02. Note 10 to the Condensed Consolidated Financial Statements provides details on the Company's current lease arrangements. While the Company continues to evaluate the impact of this new standard on its consolidated financial statements, the Company currently expects the primary impact will be to record right-of-use assets and lease liabilities for existing operating leases in the consolidated balance sheets. The Company does not currently expect the adoption of this new standard to have a material impact on its consolidated results of operations or cash flows.

In August 2016, the FASB issued Update No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash

Receipts and Cash Payments. This new standard addresses eight specific cash flow issues related to cash receipts and cash payments with the objective of reducing the existing diversity of presentation and classification in the statement of cash flows. The new standard will be effective for the Company beginning on January 1, 2019. Early adoption is permitted and should be applied using a retrospective transition method to each period presented. The Company is evaluating the impact of this standard on its consolidated cash flow statement.

In June 2018, the FASB issued Update No. 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This update will require an entity to apply the requirements of Topic 718 to nonemployee awards except for specific guidance on inputs to an option pricing model and the attribution of cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period). The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606. The new standard will be effective for the Company beginning on January 1, 2020. Early adoption is permitted but no earlier

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

than an entity's adoption date of Topic 606. The Company is evaluating the impact of this standard on its consolidated financial statements.

In July 2018, the FASB issued Update No. 2018-09, Codification Improvements. This Update includes several amendments to the Codification intended to clarify, improve, or correct errors in the Codification. Some amendments do not require transition guidance and are effective upon issuance. The amendments requiring transition guidance will be effective for the Company beginning on January 1, 2020. The Company is evaluating the impact of this standard on its consolidated financial statements.

In August 2018, the FASB issued Update No. 2018-13, Fair Value Measurement (Topic 820)-Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this Update modify the disclosure requirements on fair value measurements in Topic 820 based on the concepts in the Concepts Statement including the consideration of costs and benefits. The new standard will be effective for the Company beginning on January 1, 2020. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The Company is evaluating the impact of this standard on its consolidated financial statements.

In August 2018, the FASB issued Update No. 2018-15, Intangibles-Goodwill and Other-Internal Use Software (Subtopic 350-40). The amendments in this Update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The new standard will be effective for the Company beginning on January 1, 2021. Early adoption is permitted. The Company is evaluating the impact of this standard on its consolidated financial statements.

Recently Adopted Accounting Standards

In May 2017, the FASB issued Update No. 2017-09, Compensation- Stock Compensation (Topic 718): Scope of Modification Accounting. The new standard provides guidance regarding which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The new standard was effective for the Company beginning on January 1, 2018. Adoption of this new guidance had no impact on the Company's consolidated financial statements.

Net Loss Per Share

Basic and diluted net loss per share was calculated using the weighted-average number of shares of common stock outstanding during the period. The weighted average number of shares used to compute diluted net loss per share excludes any assumed exercise of stock options, any assumed issuance of common stock under restricted stock awards and units, and any assumed issuances under the employee stock purchase plan, as the effect, in each case, would be antidilutive. Common stock equivalents of 3.4 million shares for each of the three and nine months ended September 30, 2018, and 2017 were excluded from the calculation because of their antidilutive effect.

3. TRANSACTIONS WITH INTEGRA

Prior to the spin-off, and pursuant to certain supply agreements subsequent to the spin-off, SeaSpine purchased a portion of raw materials and finished goods from Integra for SeaSpine's Mozaik family of products, and SeaSpine contract manufactured certain finished goods for Integra. The Company's purchases of raw materials and Mozaik product finished goods from Integra totaled \$0.1 million and \$0.4 million for the three and nine months ended September 30, 2017, respectively. The Company's sale of finished goods sold to Integra under its contract

manufacturing arrangement was immaterial for the three months ended September 30, 2017 and totaled \$0.4 million for the nine months ended September 30, 2017. The Company determined that Integra does not meet the definition of a related party requiring disclosure in accordance with Accounting Standards Codification Topic 850, Related Party Disclosures as of September 30, 2018.

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. DEBT AND INTEREST

Credit Agreement

In December 2015, the Company entered into a three-year credit facility with Wells Fargo Bank, National Association, which was amended in October 2016 and in July 2018 (as amended, the Credit Facility). The Credit Facility provides an asset-backed revolving line of credit of up to \$30.0 million with a maturity date of July 27, 2021, which is subject to a one-time, one-year extension at the Company's election. In addition, under the Credit Facility, at any time through July 27, 2020, the Company may increase the \$30.0 million borrowing limit by up to an additional \$10.0 million, subject to the Company having sufficient amounts of eligible accounts receivable and inventory and to customary conditions precedent, including obtaining the commitment of lenders to provide such additional amount. In connection with the Credit Facility, the Company was required to become a guarantor and to provide a security interest in substantially all its assets for the benefit of the counterparty.

In June 2018 and September 2018, the Company borrowed \$4.0 million and \$3.0 million under the Credit Facility, respectively. The Company elected to have the LIBOR rate apply to the amounts borrowed with an interest period of six months commencing on June 28, 2018 and three months commencing on September 25, 2018, respectively. At September 30, 2018, \$7.3 million in total debt was outstanding, and the Company had \$15.3 million of current borrowing capacity, under the Credit Facility. As of September 30, 2018, the effective interest rate on the amounts borrowed was 4.95%. There were no amounts outstanding under the Credit Facility at December 31, 2017. Debt issuance costs and legal fees related to the Credit Facility totaling \$0.6 million were recorded as a deferred asset and are being amortized ratably over the term of the arrangement.

On November 2, 2018 the Company repaid the entire \$7.3 million of outstanding borrowings under the Credit Facility.

Borrowings under the Credit Facility accrue interest at the rate then applicable to base rate loans (as customarily defined), unless and until converted into LIBOR rate loans (as customarily defined) in accordance with the Credit Facility. Borrowings bear interest at a floating annual rate equal to (a) during any month for which the Company's average excess availability (as customarily defined) is greater than \$20.0 million, (i) base rate plus 1.25 percentage points for base rate loans and (ii) LIBOR rate plus 2.25 percentage points for LIBOR rate loans, (b) during any month for which the Company's average excess availability is greater than \$10.0 million but less than or equal to \$20.0 million, (i) base rate plus 1.50 percentage points for base rate loans and (ii) LIBOR rate plus 2.50 percentage points for LIBOR rate loans and (c) during any month for which the Company's average excess availability is less than or equal to \$10.0 million, (i) base rate plus 1.75 percentage points for base rate loans and (ii) LIBOR rate plus 2.75 percentage points for LIBOR rate loans. The Company will also pay an unused line fee based on the average amount borrowed under the Credit Facility for the most recently completed month. If such average amount is 25% or greater of the maximum borrowing capacity, the unused fee will be equal to 0.375% per annum of the amount unused under the Credit Facility, and if such average amount is less than 25%, the unused line fee will be equal to 0.50% per annum of the amount unused under the Credit Facility. The unused line fee is due on the first day of each month.

The Credit Facility contains various customary affirmative and negative covenants, including prohibiting the Company from incurring indebtedness without the lender's consent. The Credit Facility also includes a financial covenant that requires the Company to maintain a minimum fixed charge coverage ratio of 1.10 to 1.00 for the applicable measurement period, if the Company's Total Liquidity (as defined in the Credit Facility) is less than \$5.0 million. The Company was in compliance with all applicable covenants at September 30, 2018.

The Credit Facility also includes customary events of default, including events of default relating to non-payment of amounts due under the Credit Facility, material inaccuracy of representations and warranties, violation of covenants, bankruptcy and insolvency, failure to comply with health care laws, violation of certain of the Company's existing agreements, and the occurrence of a change of control. Under the Credit Facility, if an event of default occurs, the lender will have the right to terminate the commitments and accelerate the maturity of any loans outstanding.

SEASPINE HOLDINGS CORPORATION
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. INVENTORIES

Inventories consisted of:

	September 30, 2018	December 31, 2017
	(In thousands)	
Finished goods	\$27,327	\$ 31,008
Work in process	11,517	6,909
Raw materials	4,098	3,804
	\$42,942	\$ 41,721

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at historical cost less accumulated depreciation and any impairment charges. The Company provides for depreciation using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the lease term or the useful life. The cost of major additions and improvements is capitalized, while maintenance and repair costs that do not improve or extend the lives of the respective assets are charged to operations as incurred. The cost of computer software obtained for internal use is accounted for in accordance with the Accounting Standards Codification (ASC) 350-40, Internal-Use Software. The cost of purchased spinal instruments which the Company consigns to hospitals and independent sales agents to support surgeries is initially capitalized as construction in progress. The amount is either then reclassified to spinal instruments and sets and depreciation is initiated when instruments are put together in a newly built set with spinal implants, or directly expensed for the instruments used to replace damaged instruments in an existing set. The depreciation expense and direct expense for replacement instruments are recorded in selling, general and administrative expense.

Property, plant and equipment balances and corresponding useful lives were as follows:

	September 30, 2018	December 31, 2017	Useful Lives
	(In thousands)		
Leasehold improvement	\$5,625	\$ 5,312	Lease Term
Machinery and production equipment	7,775	7,030	3-10 years
Spinal instruments and sets	22,411	20,340	5 years
Information systems and hardware	7,526	7,375	3-7 years
Furniture and fixtures	1,246	991	3-5 years
Construction in progress	7,739	8,136	
Total	52,322	49,184	
Less accumulated depreciation and amortization	(29,373)	(27,121)	
Property, plant and equipment, net	\$22,949	\$ 22,063	

Depreciation expenses totaled \$1.1 million and \$1.0 million for the three months ended September 30, 2018 and 2017, respectively, and \$3.1 million and \$3.1 million for the nine months ended September 30, 2018 and 2017, respectively. The cost of purchased instruments used to replace damaged instruments in existing sets and recorded directly to instrument replacement expense totaled \$0.3 million and \$0.4 million for the three months ended September 30, 2018 and 2017, respectively, and \$1.3 million and \$1.1 million for the nine months ended September 30, 2018 and 2017, respectively.

7. IDENTIFIABLE INTANGIBLE ASSETS

Identifiable intangible assets are initially recorded at fair value at the time of acquisition, generally using an income or cost approach. The Company capitalizes costs incurred to renew or extend the term of recognized intangible assets and

amortizes those costs over their expected useful lives.

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SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The components of the Company's identifiable intangible assets were:

	September 30, 2018			
	Weighted		Accumulated	Net
	Average	Cost	Amortization	
	Life			
	(Dollars in thousands)			
Product technology	12 years	\$40,769	\$ (28,321)	\$ 12,448
Customer relationships	12 years	56,830	(38,942)	17,888
Trademarks/brand names	—	300	(300)	—
		\$97,899	\$ (67,563)	\$ 30,336

	December 31, 2017			
	Weighted		Accumulated	Net
	Average	Cost	Amortization	
	Life			
	(Dollars in thousands)			
Product technology	12 years	\$40,769	\$ (25,827)	\$ 14,942
Customer relationships	12 years	56,830	(36,565)	20,265
Trademarks/brand names	—	300	(300)	—
		\$97,899	\$ (62,692)	\$ 35,207

Annual amortization expense (including amounts reported in cost of goods sold) is expected to be approximately \$6.5 million in 2018, \$5.8 million in 2019, \$4.9 million in 2020, \$4.9 million in 2021 and \$4.8 million in 2022. For the three months ended September 30, 2018 and 2017, amortization expense totaled \$1.6 million and \$1.7 million, respectively, and included \$0.8 million and \$0.9 million, respectively, of amortization of product technology intangible assets that is presented within cost of goods sold. Amortization expense totaled \$4.9 million and \$5.1 million for the nine months ended September 30, 2018 and 2017, respectively, and included \$2.5 million and \$2.7 million, respectively, of amortization of product technology intangible assets that is presented within cost of goods sold.

8. FAIR VALUE MEASUREMENTS

The Company is obligated to pay up to \$5.0 million in milestone payments in connection with the August 2016 purchase of certain assets of N.L.T Spine Ltd. (NLT) and NLT Spine, Inc., a wholly owned subsidiary of NLT, payable at the Company's election in cash or in shares of its common stock. Such milestone payments are contingent on the Company's achievement of four independent events related to the commercialization of the product technologies the Company acquired in the transaction. Additionally, the Company must pay royalty payments, in cash, to NLT equal to declining (over time) percentages of the Company's future net sales of certain of the acquired product technologies not to exceed \$43.0 million in the aggregate. The Company has the option to terminate any future obligation to make royalty payments by making a one-time cash payment to NLT of \$18.0 million.

The fair values of the Company's assets and liabilities, including contingent consideration liabilities mentioned above, are measured at fair value on a recurring basis, and are determined under the fair value categories as follows (in thousands):

Total	Quoted	Significant	Significant
	Price in	Other	Unobservable
	Active	Observable	Inputs (Level
	Market	Inputs	3)

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(Level 1) (Level 2)

September 30, 2018:

Contingent consideration liabilities- current	\$793	\$	—\$	—\$ 793
Contingent consideration liabilities- non-current	2,636	—	—	2,636
Total contingent consideration	\$3,429	\$	—\$	—\$ 3,429

December 31, 2017:

Contingent consideration liabilities- current	\$207	\$	\$ 207
Contingent consideration liabilities- non-current	4,228	—	4,228
Total contingent consideration	\$4,435	\$	\$ 4,435

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SEASPINE HOLDINGS CORPORATION
 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Contingent consideration liabilities are classified within Level 3 of the fair value hierarchy because they use significant unobservable inputs. For those liabilities, fair value is determined using a probability-weighted discounted cash flow model and significant inputs which are not observable in the market. The significant inputs include assumptions related to the timing and probability of the product launch dates, estimated future sales of the products, discount rates matched to the timing of payments, and probability of success rates.

The following table sets forth the changes in the estimated fair value of the Company's liabilities measured on a recurring basis using significant unobservable inputs (Level 3). The gain or loss from change in fair value of contingent milestone and royalty payments results from updated estimated timing of payments, probability of success rates, the passage of time, updated discount rates matched to the estimated timing of payments, actual net sales of certain products for the three and nine months ended September 30, 2018, and estimated net sales for future royalty payment periods.

Future changes in estimated timing of payments, probability of success rates, or estimated net sales for upcoming royalty payment periods would be expected to have a material impact on the fair value of contingent milestone and royalty payments.

Three Months Ended September 30, 2018:	(in thousands)
Balance as of June 30, 2018	\$ 3,651
Contingent consideration liabilities settled	(46)
Gain from change in fair value of contingent consideration recorded in selling, general and administrative expenses	(176)
Fair value at September 30, 2018	\$ 3,429
Nine Months Ended September 30, 2018:	(in thousands)
Balance as of January 1, 2018	\$ 4,435
Contingent consideration liabilities settled	(113)
Gain from change in fair value of contingent consideration recorded in selling, general and administrative expenses	(893)
Fair value at September 30, 2018	\$ 3,429

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. EQUITY AND STOCK-BASED COMPENSATION

Common Stock

On January 31, 2017, the Company issued 350,000 shares of common stock to NLT as the settlement of contingent closing consideration pursuant to the terms of the asset purchase agreement entered into with NLT in August 2016. The total fair value of such shares was \$2.5 million at issuance.

In August 2016, the Company entered into an equity distribution agreement (Distribution Agreement) with Piper Jaffray & Co. (Piper Jaffray), pursuant to which the Company may offer and sell shares of its common stock in “at the market” (ATM) offerings (as defined in Rule 415 of the Securities Act of 1933, as amended) having an aggregate offering price up to \$25.0 million in gross proceeds from time to time through Piper Jaffray acting as sales agent. The shares offered and sold under the Distribution Agreement are covered by a registration statement on Form S-3 that was declared effective on August 24, 2016. Under the Distribution Agreement, during the nine months ended September 30, 2018, the Company sold 882,332 shares of common stock at an average price per share of \$10.00 and received net proceeds of approximately \$8.5 million (net of \$0.3 million of offering costs). The Company has consumed the \$25.0 million in capacity under the Distribution Agreement as of September 30, 2018. The Company intends to continue using the net proceeds for general corporate purposes, including sales and marketing expenditures aimed at growing its business, research and development expenditures focused on product development, and investments in inventory and spinal instruments and sets.

In May 2018, the Company entered into another equity distribution agreement with Piper Jaffray (the May 2018 Distribution Agreement), pursuant to which the Company may offer and sell shares of its common stock in ATM offerings having an aggregate offering price up to \$50.0 million in gross proceeds from time to time through Piper Jaffray acting as sales agent. The shares offered and sold under the May 2018 Distribution Agreement are covered by a registration statement on Form S-3 that was declared effective on August 24, 2016. The Company did not sell any shares of common stock under the May 2018 Distribution Agreement during the nine months ended September 30, 2018. Future sales, if any, will depend on a variety of factors including, but not limited to, market conditions, the trading price of the Company's common stock and the Company's capital needs. The Company intends to use any net proceeds for general corporate purposes, including sales and marketing expenditures aimed at growing its business, research and development expenditures focused on product development, and investments in inventory and spinal instruments and sets.

Equity Award Plans

As of June 30, 2015, Integra had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock units outstanding under three plans, the 2000 Equity Incentive Plan, the 2001 Equity Incentive Plan, and the 2003 Equity Incentive Plan. In connection with the spin-off, Integra equity awards granted to individuals who became employees of SeaSpine were converted to equity awards denominated in SeaSpine common stock. In general, each post-conversion award is subject to the same terms and conditions as were applicable to the pre-conversion award.

In May 2015, the Company adopted the 2015 Incentive Award Plan, which was subsequently amended and restated with approval of the Company's stockholders. In February and March 2018, the Company's board of directors approved amendments to the plan that increased the share reserve by an aggregate of 2,726,000 shares over the then-existing share reserve thereunder, subject to stockholder approval. The Company's stockholders approved both amendments on May 30, 2018 (the 2015 Incentive Award Plan, as amended and restated to date, the Restated Plan). Under the Restated Plan, the Company can grant its employees, non-employee directors and consultants incentive

stock options and non-qualified stock options, restricted stock, performance stock, dividend equivalent rights, stock appreciation rights, stock payment awards and other incentive awards. The aggregate number of shares that may be issued or transferred pursuant to awards under the Restated Plan is the sum of (1) the number of shares issuable upon exercise or vesting of the number of Integra equity awards converted to the Company's equity awards under the Restated Plan as of the date of the spin-off and (2) 6,235,500, which shares may be authorized but unissued shares, or shares purchased in the open market. As of September 30, 2018, 2,648,561 shares were available for issuance under the Restated Plan.

In 2016, the Company established the 2016 Employment Inducement Incentive Award Plan (the 2016 Inducement Plan), a broad-based incentive plan which allows for the issuance of stock-based awards, including non-qualified stock options, restricted stock awards, performance awards, restricted stock unit awards and stock appreciation rights, to any prospective officer or other employee who has not previously been an employee or director of the Company or an affiliate or who is commencing employment with the Company or an affiliate following a bona-fide period of non-employment by the Company or an affiliate. An aggregate of 1,000,000 shares are reserved for issuance under the 2016 Inducement Plan. The Company has

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

not awarded any shares under the 2016 Inducement Plan as of September 30, 2018. As a result of the stockholders' approval of the Restated Plan, the Company's board of directors will not grant any awards under the 2016 Inducement Plan.

In June 2018, the Company established the 2018 Employment Inducement Incentive Award Plan (the 2018 Inducement Plan). The terms of the 2018 Plan are substantially similar to the terms of the Restated Plan with three principal exceptions: (1) incentive stock options may not be granted under the 2018 Inducement Plan; (2) there are no annual limits on awards that may be issued to an individual under the 2018 Inducement Plan; and (3) awards granted under the 2018 Inducement Plan are not required to be subject to any minimum vesting period. An aggregate of 2,000,000 shares are reserved under the 2018 Inducement Plan. As of September 30, 2018, 1,888,457 shares were available for issuance under the 2018 Inducement Plan.

Both the 2016 Inducement Plan and the 2018 Inducement Plan were adopted by the Company's board of directors without stockholder approval pursuant to Rule 5635(c)(4) of the Nasdaq Listing Rules. In accordance with Rule 5635(c)(4) of the Nasdaq Listing Rules, awards under either of those plans may only be made to an employee who has not previously been an employee or member of the Company's board of directors or of any board of directors of any parent or subsidiary of the Company, or following a bona fide period of non-employment by the Company or a parent or subsidiary, if he or she is granted such award in connection with his or her commencement of employment with the Company or a subsidiary and such grant is an inducement material to his or her entering into employment with the Company or such subsidiary.

Forfeiture Rate Assumptions

Stock-based compensation expense related to all equity awards includes an estimate for forfeitures. The expected forfeiture rate of all equity-based compensation is based on historical experience of pre-vesting forfeitures on awards and options by each homogenous group of shareowners. For awards and options granted to non-executive employees, the forfeiture rate is estimated to be 13% annually for the nine months ended September 30, 2018 and 15% annually for the nine months ended September 30, 2017. There is no forfeiture rate applied to awards or options granted to non-employee directors or executive employees because their pre-vesting forfeitures are anticipated to be highly unlikely. As individual awards and options become fully vested, stock-based compensation expense is adjusted to recognize actual forfeitures.

Restricted Stock Awards and Restricted Stock Units

The Company expenses the fair value of restricted stock awards and of restricted stock units on an accelerated basis over the vesting period or requisite service period, whichever is shorter.

There were no shares of restricted stock awards granted to non-employee directors during the three months ended September 30, 2018. During the nine months ended September 30, 2018, there were 95,658 shares of restricted stock awards granted to non-employee directors. During the three and nine months ended September 30, 2018, there were 67,319 and 554,600 restricted stock units granted to employees, respectively. Of such restricted stock units granted to employees, 341,808 were granted, in part, out of the increase to the share reserve under the Restated Plan adopted by the Company's board of directors on February 1, 2018, all of which were granted subject to stockholder approval of the Restated Plan (the Contingent RSUs). On May 30, 2018, the Company's stockholders approved the Restated Plan, and in accordance with the ASC 718, Compensation-Stock Compensation, the Company began recognizing the expense for the Contingent RSUs over the requisite service period.

There were no shares of restricted stock awards granted to non-employee directors during the three months ended September 30, 2017. During the nine months ended September 30, 2017, the Company granted 120,610 shares of restricted stock awards to non-employee directors. During the three and nine months ended September 30, 2017, there were 34,800 and 778,755 restricted stock units granted to employees, respectively. Of such restricted stock units, 131,523 were granted in lieu of cash bonuses earned under the Company's annual incentive program for corporate and

individual performance in 2016.

As of September 30, 2018, there was approximately \$5.5 million of unrecognized compensation expense related to the unvested portions of restricted stock awards and of restricted stock units. This expense is expected to be recognized over a weighted-average period of approximately 1.5 years.

Stock Options

Stock option grants to employees generally have a requisite service period of four years, and stock option grants to non-employee directors generally have a requisite service period of one year. Both are subject to graded vesting. The Company records stock-based compensation expense associated with stock options on an accelerated basis over the applicable vesting period within each grant and based on their fair value at the date of grant using the Black-Scholes-Merton option pricing model. There were 22,500 and zero stock options granted during the three months ended September 30, 2018 and 2017, respectively,

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

and 27,500 and 21,500 stock options granted during the nine months ended September 30, 2018 and 2017, respectively. The following weighted-average assumptions were used in the calculation of fair value for options granted during the period indicated.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Expected dividend yield	0	%	—	0
Risk-free interest rate	2.8	%	—	2.8
Expected volatility	25.6	%	—	25.6
Expected term (in years)	4.9		—	4.9

The Company considered that it has never paid, and does not currently intend to pay, cash dividends. The risk-free interest rates are derived from the U.S. Treasury yield curve in effect on the date of grant for instruments with a remaining term similar to the expected term of the options. Due to the Company's limited historical data, the expected volatility is calculated based upon the historical volatility of comparable companies in the medical device industry whose share prices are publicly available for a sufficient period of time. The expected term of "plain vanilla" options is calculated using the simplified method as prescribed by accounting guidance for stock-based compensation. A "plain vanilla" option is an option with the following characteristics: (1) the option is granted at-the-money; (2) exercisability is conditional only on satisfaction of a service condition through the vesting date; (3) employees who terminate their service prior to vesting forfeit the option; (4) employees who terminate their service after vesting are granted limited time to exercise their options; and (5) the option is nontransferable and non-hedgeable. The expected term of any other option is based on disclosures from similar companies with similar grants.

As of September 30, 2018, there was approximately \$0.4 million of unrecognized compensation expense related to unvested stock options. This expense is expected to be recognized over a weighted-average period of approximately 0.7 years.

Employee Stock Purchase Plan

In May 2015, the Company adopted the SeaSpine Holdings Corporation 2015 Employee Stock Purchase Plan, which was amended in December 2015 (as amended, the ESPP). Under the ESPP, eligible employees may purchase shares of the Company's common stock through payroll deductions of up to 15% of eligible compensation during an offering period. Generally, each offering period will be for twenty-four months as determined by the Company's board of directors. There are four six-month purchase periods in each offering period for contributions to be made and to be converted into shares at the end of the purchase period. In no event may an employee purchase more than 2,500 shares per purchase period based on the closing price on the first trading date of an offering period or more than \$25,000 worth of stock during any calendar year. The purchase price for shares to be purchased under the ESPP is 85% of the lesser of the market price of the Company's common stock on the first trading date of an offering period or on any purchase date during an offering period (June 30 or December 31).

The ESPP authorizes the issuance of up to 400,000 shares of common stock pursuant to purchase rights granted to employees. The ESPP is intended to qualify as an "employee stock purchase plan" within the meaning of Section 423 of the Internal Revenue Code of 1986, as amended. The ESPP contains a restart feature, such that if the market price of the stock at the end of any six-month purchase period is lower than the market price at the original grant date of an offering period, that offering period will terminate after that purchase date, and a new two-year offering period will commence on the January 1 or July 1 immediately following the date the original offering period terminated. This restart feature was triggered on the purchase date that occurred on December 31, 2016, such that the offering period that commenced on July 1, 2016 was terminated, and a new two-year offering period commenced on January 1, 2017

and is scheduled to end on December 31, 2018. The Company applied share-based payment modification accounting to the awards that were initially valued at the grant date to determine the amount of any incremental fair value associated with the modified awards. The impact to stock-based compensation expense for modifications during the nine months ended September 30, 2018 was immaterial.

During the nine months ended September 30, 2018 and 2017, there were 80,907 and 70,537 shares of common stock, respectively, purchased under the ESPP. The Company recognized \$0.2 million and \$0.4 million, respectively, in expense related to the ESPP for each of the nine months ended September 30, 2018 and 2017.

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company estimates the fair value of shares issued to employees under the ESPP using the Black-Scholes-Merton option-pricing model. The following weighted average assumptions were used in the calculation of fair value of shares under the ESPP at the grant date for the periods indicated:

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Expected dividend yield	0 %	0 %	0 %	0 %
Risk-free interest rate	2.4 %	1.3 %	2.0 %	1.0 %
Expected volatility	34.2 %	25.3 %	29.4 %	28.1 %
Expected term (in years)	1.3	1.2	1.3	1.2

10. LEASES

The Company leases administrative, manufacturing, research, and distribution facilities and various manufacturing, office and transportation equipment through operating lease agreements.

Future minimum lease payments under the Company's operating leases at September 30, 2018 are as follows:

	Payments Due by Calendar Year (In thousands)
2018	\$ 551
2019	2,129
2020	2,179
2021	2,220
2022	2,241
Thereafter	6,233
Total minimum lease payments	\$ 15,553

Total lease expense was \$0.5 million for each of the three months ended September 30, 2018 and 2017 and \$1.6 million for each of the nine months ended September 30, 2018 and 2017.

11. INCOME TAXES

The following table summarizes the Company's effective tax rate for the periods indicated:

	Three		Nine	
	Months		Months	
	Ended		Ended	
	September		September	
	30,	30,	30,	30,
	2018	2017	2018	2017

Reported income tax benefit (expense) rate	1.1 %	0.8 %	%	%
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The Company reported an income tax benefit for the three months ended September 30, 2018 primarily related to the release of its ASC 740-10 (FIN 48) liabilities due to the expiration of the statute of limitations, offset by income tax

related to foreign and state operations. The Company reported an income tax expense for the nine months ended September 30, 2018 primarily related to foreign and state operations, offset by the release of its ASC 740-10 (FIN 48) liabilities due to the expiration of the statute of limitations.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate rate from 35% to 21%, requires companies to pay a one-time transition tax on accumulated earnings of certain foreign subsidiaries previously deferred from tax and creates a new provision designed to tax global intangible low-taxed income (GILTI).

The Company is not subject to the one-time transition tax on accumulated foreign earnings or the GILTI provisions enacted by the Act because the Company's foreign operations have been included in its US tax filings pursuant to an election to disregard its foreign entity for federal income tax purposes.

In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because the Company has concluded that it is more likely than not that the Company will be unable to realize the value of

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

any resulting deferred tax assets. The Company will continue to assess its position in future periods to determine if it is appropriate to reduce a portion of its valuation allowance in the future.

12. COMMITMENTS AND CONTINGENCIES

In consideration for certain technology, manufacturing, distribution, and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on sales of certain products sold by the Company. Except for the royalties payable to NLT, the royalty payments that the Company made under these agreements are included in the condensed consolidated statements of operations as a component of cost of goods sold.

The Company is subject to various legal proceedings in the ordinary course of its business with respect to its products, its current or former employees, and its commercial relationships, some of which have been settled by the Company. In the opinion of management, such proceedings are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to result in a material adverse effect on the Company's financial condition. However, it is possible that the Company's results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

The Company accrues for loss contingencies when it is deemed probable that a loss has been incurred and that loss is estimable. The amounts accrued are based on the full amount of the estimated loss before considering insurance proceeds, and do not include an estimate for legal fees expected to be incurred in connection with the loss contingency. While uncertainty exists, the Company does not believe there are any pending legal proceedings that would have a material impact on the Company's financial position, cash flows or results of operations.

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

13. SEGMENT AND GEOGRAPHIC INFORMATION

Management assessed its segment reporting based on how it internally manages and reports the results of its business to its chief operating decision maker. Management reviews financial results, manages the business and allocates resources on an aggregate basis. Therefore, financial results are reported in a single operating segment: the development, manufacture and marketing of orthobiologics and spinal implants. The Company reports revenue in two product categories: orthobiologics and spinal implants. Orthobiologics products consist of a broad range of advanced and traditional bone graft substitutes that are designed to improve bone fusion rates following a wide range of orthopedic surgeries, including spine, hip and extremities procedures. The spinal implants portfolio consists of an extensive line of products to facilitate spinal fusion in minimally invasive surgery, complex spine, deformity and degenerative procedures.

Revenue, net consisted of:

	Three Months		Nine Months	
	Ended September		Ended September	
	30,		30,	
	2018	2017	2018	2017
Orthobiologics	\$18,529	\$16,333	\$55,186	\$51,073
Spinal implants	17,305	15,409	50,232	46,759
Total revenue, net	\$35,834	\$31,742	\$105,418	\$97,832

The Company attributes revenues to geographic areas based on the location of the customer. Total revenue by major geographic area consisted of:

	Three Months		Nine Months	
	Ended September		Ended September	
	30,		30,	
	2018	2017	2018	2017
United States	\$31,717	\$28,245	\$93,894	\$87,209
International	4,117	3,497	11,524	10,623
Total revenue, net	\$35,834	\$31,742	\$105,418	\$97,832

SEASPINE HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

14. SUBSEQUENT EVENTS

On October 11, 2018, the Company entered into an Underwriting Agreement (Underwriting Agreement) with Wells Fargo Securities, LLC, Piper Jaffray & Co. and Cantor Fitzgerald & Co. acting as joint bookrunning managers and as representatives of the underwriters relating to the issuance and sale of 3,250,000 shares of the Company's common stock. The price to the public in the offering was \$15.50 per share, before underwriting discounts and commissions. Under the terms of the Underwriting Agreement, the Company granted the underwriters an option, exercisable for 30 days, to purchase up to an additional 487,500 shares of common stock. The underwriters exercised this option and the offering closed on October 15, 2018 with the sale of 3,737,500 shares of the Company's common stock. The net proceeds to the Company from the offering were approximately \$54.1 million, after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company. The Company has used a portion of the net proceeds from the offering to repay all of its outstanding borrowings under the Company's credit facility with Wells Fargo Bank, National Association, and intends to use the remaining proceeds for general corporate purposes, including general and administrative expenses, capital expenditures and general working capital purposes.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The terms "we," "us," "our," "SeaSpine" or the "Company" refer collectively to SeaSpine Holdings Corporation and its wholly-owned subsidiaries, unless otherwise stated. All information in this report is based on our fiscal year. Unless otherwise stated, references to particular years, quarters, months or periods refer to our fiscal years ending December 31 and the associated quarters, months and periods of those fiscal years.

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). The matters discussed in these forward-looking statements are subject to risk and uncertainties that could cause actual results to differ materially from those made, projected or implied in the forward-looking statements. Such risks and uncertainties may also give rise to future claims and increase exposure to contingent liabilities. Please see the "Risk Factors" section in our Annual Report on Form 10-K for the year ended December 31, 2017 (the 2017 10-K) for a discussion of the uncertainties, risks and assumptions associated with these statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

You can identify these forward-looking statements by forward-looking words such as "believe," "may," "could," "will," "estimate," "continue," "anticipate," "intend," "seek," "plan," "expect," "should," "would" and similar expressions.

These risks and uncertainties arise from (among other factors):

• general economic and business conditions, in both domestic and international markets;

• our expectations and estimates concerning future financial performance, financing plans and the impact of competition;

• anticipated trends in our business, including healthcare reform in the United States, increased pricing pressure from our competitors or hospitals, exclusion from major healthcare systems, whether as a result of unwillingness to provide required pricing or otherwise, and changes in third-party payment systems;

• physicians' willingness to adopt our recently launched and planned products, customers' continued willingness to pay for our products and third-party payors' willingness to provide or continue coverage and appropriate reimbursement for any of our products and our ability to secure regulatory approval for products in development;

existing and future regulations affecting our business, both in the United States and internationally, and enforcement of those regulations;

anticipated demand for our products and our ability to purchase or produce our products in sufficient quantities to meet customer demand;

our ability to manage timelines and costs related to manufacturing our products;

our ability to attract and retain new, high-quality independent sales agents, whether because of inability to agree on financial or other contractual terms or otherwise, disruption to our existing distribution network as new independent sales agents are added, and the ability of new independent sales agents to generate growth or offset disruption to existing independent sales agents;

our ability to successfully develop new and next-generation products and the costs associated with designing and developing those new and next-generation products;

our ability to support the safety and efficacy of our products with long-term clinical data;

our ability to obtain additional debt and equity financing to fund capital expenditures and working capital requirements and acquisitions;

the risk of supply shortages, including our dependence on a limited number of third-party suppliers for components and raw materials;

our ability to protect our intellectual property, including unpatented trade secrets, and to operate without infringing or misappropriating the proprietary rights of others;

our ability to complete acquisitions, integrate operations post-acquisition and maintain relationships with customers of acquired entities; and

other risk factors described in the section entitled “Risk Factors” of the 2017 10-K.

These factors should not be construed as exhaustive and should be read with the other cautionary statements included in this report.

Overview

We are a global medical technology company focused on the design, development and commercialization of surgical solutions for the treatment of patients suffering from spinal disorders. We have a comprehensive portfolio of orthobiologics and spinal implant solutions to meet the varying combinations of products that neurosurgeons and orthopedic spine surgeons need to perform fusion procedures in the lumbar, thoracic and cervical spine. We believe this broad combined portfolio of orthobiologics and spinal implant products is essential to meet the “complete solution” requirements of such surgeons.

We report revenue in two product categories: orthobiologics and spinal implants. Our orthobiologics products consist of a broad range of advanced and traditional bone graft substitutes that are designed to improve bone fusion rates following a wide range of orthopedic surgeries, including spine, hip, and extremities procedures. Our spinal implant portfolio consists of an extensive line of products to facilitate spinal fusion in minimally invasive surgery, complex spine, deformity and degenerative procedures.

Our U.S. sales organization consists of regional and territory managers who oversee a broad network of independent orthobiologics and spinal implant sales agents. We pay these sales agents commissions based on the sales of our products. Our international sales organization consists of a sales management team that oversees a network of independent orthobiologics and spinal implant stocking distributors that purchase products directly from us and independently sell them. Our policy is not to sell our products through or to participate in physician-owned distributorships.

SeaSpine was incorporated in Delaware on February 12, 2015 in connection with the spin-off of the orthobiologics and spinal implant business of Integra LifeSciences Holdings Corporation. The spin-off occurred on July 1, 2015.

Components of Our Results of Operations

Revenue

Our net revenue is derived primarily from the sale of orthobiologics and spinal implant products across North America, Europe, Asia Pacific and Latin America. Sales are reported net of returns, rebates, group purchasing organization fees and other customer allowances.

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In the United States, we generate most of our revenue by consigning our orthobiologics products and by consigning or loaning our spinal implant sets to hospitals and independent sales agents, who in turn either deliver them to hospitals for a single surgical procedure, after which they are returned to us, or leave them with hospitals that are high volume users for multiple procedures. The spinal implant sets typically contain the instruments, disposables, and spinal implants required to complete a surgery. We ship replacement inventory to independent sales agents to replace the consigned inventory used in surgeries. We maintain and replenish loaned sets at our kitting and distribution centers and return replenished sets to a hospital or independent sales agent for the next procedure. We recognize revenue on these consigned or loaned products when they have been used or implanted in a surgical procedure.

For all other sales transactions, including sales to international stocking distributors and private label partners, we generally recognize revenue when the products are shipped to the customer or stocking distributor and the transfer of title and risk of loss occurs. There is generally no customer acceptance or other condition that prevents us from recognizing revenue in accordance with the delivery terms for these sales transactions.

Cost of Goods Sold

Cost of goods sold primarily consists of the costs of finished goods purchased directly from third parties and raw materials used in the manufacture of our products, plant and equipment overhead, labor costs and packaging costs. The majority of our orthobiologics products are designed and manufactured internally. The cost of human tissue and fixed manufacturing overhead costs are significant drivers of the cost of goods sold and consequently our orthobiologics products, at current production volumes, generate lower gross margin than our spinal implant products. We rely on third-party suppliers to manufacture our spinal implant products, and we assemble them into surgical sets at our kitting and distribution centers. The cost to inspect incoming finished goods is included in the cost of goods sold. Other costs included in cost of goods sold include amortization of product technology intangible assets, royalties, scrap and consignment losses, and charges for expired, excess and obsolete inventory.

Selling, General and Administrative Expense

Our selling, general and administrative (SG&A) expenses consist primarily of sales commissions to independent sales agents, cost of medical education and training, payroll and other headcount related expenses, depreciation of instrument sets, instrument replacement expense, stock-based compensation, marketing expenses, supply chain and distribution expenses, including costs to ship our spinal implants to and from hospitals and independent sales agents, expenses for information technology, legal, human resources, insurance, finance, facilities, and management. We also record gains or losses associated with changes in the fair value of contingent consideration liabilities in SG&A expenses.

Research and Development Expense

Our research and development (R&D) expenses primarily consist of expenses related to the headcount for engineering, product development, clinical affairs and regulatory functions as well as consulting services, third-party prototyping services, outside research and clinical studies activities, and materials, production and other costs associated with development of our products. We expense R&D costs as they are incurred.

While our R&D expenses fluctuate from period to period based on the timing of specific initiatives, we expect that these costs will increase over time as we continue to design and commercialize new products and expand our product portfolio, add related personnel and conduct additional clinical activities.

Intangible Amortization

Our intangible amortization, including the amounts reported in cost of goods sold, consists of acquisition-related amortization. We expect total annual amortization expense (including amounts reported in cost of goods sold) to be approximately \$6.5 million in 2018, \$5.8 million in 2019, \$4.9 million in 2020, \$4.9 million in 2021 and \$4.8 million in 2022.

RESULTS OF OPERATIONS

(In thousands, except percentages)	Three Months Ended September 30,		2018 vs.	Nine Months Ended September 30,		2018 vs.
	2018	2017	2017 %	2018	2017	2017 %
			Change			Change
Total revenue, net	\$35,834	\$31,742	12.9 %	\$105,418	\$97,832	7.8 %
Cost of goods sold	14,247	12,176	17.0 %	40,986	39,342	4.2 %
Gross profit	21,587	19,566	10.3 %	64,432	58,490	10.2 %
Gross margin	60.2 %	61.6 %		61.1 %	59.8 %	
Operating expenses:						
Selling, general and administrative	27,041	23,674	14.2 %	76,940	71,893	7.0 %
Research and development	3,203	2,834	13.0 %	8,783	9,228	(4.8) %
Intangible amortization	792	792	— %	2,376	2,376	— %
Total operating expenses	31,036	27,300	13.7 %	88,099	83,497	5.5 %
Operating loss	(9,449)	(7,734)	22.2 %	(23,667)	(25,007)	(5.4) %
Other (expense) income, net	(190)	215	(188.4) %	(327)	387	(184.5) %
Loss before income taxes	(9,639)	(7,519)	28.2 %	(23,994)	(24,620)	(2.5) %
(Benefit) provision for income taxes	(107)	(57)	87.7 %	4	(12)	(133.3) %
Net loss	\$(9,532)	\$(7,462)	27.7 %	\$(23,998)	\$(24,608)	(2.5) %

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Revenue

Total revenue, net for the three months ended September 30, 2018, was \$35.8 million, an increase of 12.9% compared to the same period in 2017.

	Three Months Ended September 30,		2018 vs.
	2018	2017	2017 %
			Change
	(In thousands)		
Orthobiologics	\$18,529	\$16,333	13.4 %
United States	16,689	14,890	12.1 %
International	1,840	1,443	27.5 %
Spinal Implants	\$17,305	\$15,409	12.3 %
United States	15,028	13,355	12.5 %
International	2,277	2,054	10.9 %
Total revenue, net	\$35,834	\$31,742	12.9 %
	Three Months Ended September 30,		2018 vs.
	2018	2017	2017 %
			Change
	(In thousands)		
United States	\$31,717	\$28,245	12.3 %

International	4,117	3,497	17.7 %
Total revenue, net	\$35,834	\$31,742	12.9 %

Revenue from sales of orthobiologics was \$18.5 million for the three months ended September 30, 2018, an increase of \$2.2 million or 13.4%, from the same period in 2017. Revenue from sales of our orthobiologics products in the United States increased \$1.8 million to \$16.7 million for the three months ended September 30, 2018 compared to the same period in 2017. This growth was driven by recently launched products and higher sales of our legacy demineralized bone matrix (DBM)

product portfolio, and was partially offset by continuing sales declines in our collagen ceramic matrix product line. We expect future revenue growth for U.S. orthobiologics to be increasingly driven by recently launched products. Revenue from international sales of our orthobiologics products, which can be volatile from quarter to quarter because of irregular ordering patterns from our stocking distributors, increased \$0.4 million for the three months ended September 30, 2018 compared to the same period in 2017, which was primarily attributable to increased sales in Latin America.

Revenue from sales of spinal implants was \$17.3 million for the three months ended September 30, 2018, an increase of \$1.9 million or 12.3%, from the same period in 2017. Revenue from sales of spinal implants in the United States increased \$1.7 million to \$15.0 million for the three months ended September 30, 2018 compared to the same period in 2017, primarily due to growth contributed by recently launched products and, to a much lesser extent, from the negative impact in the prior year quarter of the hurricanes in Texas and the Southeast. We continue to experience low to mid-single digit pricing pressure in the U.S. spinal implant market. Revenue from international sales of spinal implants, which can be volatile from quarter to quarter because of irregular ordering patterns from our stocking distributors, increased \$0.2 million for the three months ended September 30, 2018 compared to the same period in 2017, primarily attributable to a new distributor in Australia offsetting a decline in sales in Europe and Latin America.

Cost of Goods Sold and Gross Margin

Cost of goods sold increased \$2.1 million, to \$14.2 million for the three months ended September 30, 2018, compared to the same period in 2017. Gross margin was 60.2% for the three months ended September 30, 2018 and 61.6% for the same period in 2017. The decrease in gross margin was due to higher spinal implant excess and obsolete inventory charges and orthobiologics manufacturing scrap rates and other inefficiencies associated with the production ramp up of recently launched products, which were partially offset by lower raw material costs for orthobiologic products made at our Irvine, California facility.

Cost of goods sold included \$0.8 million and \$0.9 million of amortization for product technology intangible assets for the three months ended September 30, 2018 and 2017, respectively.

Selling, General and Administrative

SG&A expenses increased \$3.4 million to \$27.0 million for the three months ended September 30, 2018 compared to the same period in 2017. The increase was mainly driven by a \$1.1 million decrease for the quarter in the gain from the change in fair value of NLT contingent consideration, and by higher sales commission expense, compensation expense primarily related to the expansion of our medical education and training organization as well as the hiring of additional product managers to support the launch of new products, and tradeshow expenses due to the earlier timing of a major U.S. tradeshow in 2018.

Research and Development

R&D expenses increased \$0.4 million to \$3.2 million, or 8.9% of revenue, for the three months ended September 30, 2018 compared to the same period in 2017. The increase was primarily driven by higher expenses related to clinical studies and outside development spending.

Intangible Amortization

Intangible amortization expense, excluding the amounts reported in cost of goods sold for product technology intangible assets, remained consistent at \$0.8 million for both the three months ended September 30, 2018 and 2017.

Income Taxes

	Three Months Ended	
	September 30,	
	2018	2017
	(In thousands)	
Loss before income taxes	\$(9,639)	\$(7,519)
Benefit for income taxes	(107)	(57)
Effective tax rate	1.1	% 0.8

We reported an income tax benefit for the three months ended September 30, 2018 and 2017 primarily related to the release of ASC 740-10 (FIN 48) liabilities due to the expiration of the statute of limitations, offset by income tax related to foreign and state operations.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate rate from 35% to 21%, requires companies to pay a one-time transition tax on accumulated earnings of certain foreign subsidiaries previously deferred from tax and creates a new provision designed to tax global intangible low-taxed income (GILTI). We are not subject to the one-time transition tax on accumulated foreign earnings or the GILTI provisions enacted by the Act because our foreign operations have been included in our US tax filings pursuant to an election to disregard our foreign entity for federal income tax purposes.

In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because we have concluded that it is more likely than not that we will be unable to realize the value of any resulting deferred tax assets.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Revenue

Total revenue, net for the nine months ended September 30, 2018 was \$105.4 million an increase of 7.8% compared to the same period in 2017.

	Nine Months Ended September 30,		2018 vs. 2017	
	2018	2017	%	
	(In thousands)		Change	
Orthobiologics	\$55,186	\$51,073	8.1	%
United States	49,140	45,967	6.9	%
International	6,046	5,106	18.4	%
Spinal Implants	\$50,232	\$46,759	7.4	%
United States	44,754	41,242	8.5	%
International	5,478	5,517	(0.7)	%
Total revenue, net	\$105,418	\$97,832	7.8	%
	Nine Months Ended September 30,		2018 vs. 2017	
	2018	2017	%	
	(In thousands)		Change	
United States	\$93,894	\$87,209	7.7	%
International	11,524	10,623	8.5	%
Total revenue, net	\$105,418	\$97,832	7.8	%

Revenue from orthobiologics sales totaled \$55.2 million for the nine months ended September 30, 2018, an increase of \$4.1 million, from the same period in 2017. Revenue from sales of our orthobiologics in the United States increased \$3.2 million for the nine months ended September 30, 2018 compared to the same period in 2017 and was driven primarily by recently launched products and growth in our legacy DBM product portfolio. This growth was partially offset by continuing sales declines in our collagen ceramic matrix product line. Revenue from international sales of

our orthobiologics products, which can be volatile from quarter to quarter because of irregular ordering patterns from our stocking distributors, increased \$0.9 million for the nine months ended September 30, 2018 compared to the same period in 2017, which was primarily attributable to increased sales in Latin America and Europe.

Revenue from spinal implant sales totaled \$50.2 million for the nine months ended September 30, 2018, an increase of \$3.5 million, from the same period in 2017. Revenue from sales of our spinal implants in the United States increased \$3.5 million for the nine months ended September 30, 2018 compared to the same period in 2017, primarily due to the revenue growth

contributed by recently launched products. We continue to experience low to mid-single digit pricing pressure in the U.S. spinal implant market. Revenue from international sales of our spinal implant products, which can be volatile from quarter to quarter because of irregular ordering patterns from our stocking distributors, remained relatively consistent for the nine months ended September 30, 2018 compared to the same period in 2017. Revenue growth from sales to a new distributor in Australia was offset by a decline in Europe and Latin America sales.

Cost of Goods Sold and Gross Margin

Cost of goods sold increased \$1.6 million, to \$41.0 million for the nine months ended September 30, 2018, compared to the same period in 2017. Gross margin was 61.1% for the nine months ended September 30, 2018, compared to 59.8% for the same period in 2017. The increase in gross margin was driven by higher international pricing in 2018 compared to 2017 and lower raw material costs for orthobiologics products manufactured at our Irvine, California facility, offset by higher orthobiologics manufacturing scrap rates.

Cost of goods sold included \$2.5 million and \$2.7 million of amortization for product technology intangible assets, for the nine months ended September 30, 2018 and 2017, respectively.

Selling, General and Administrative

SG&A expenses increased \$5.0 million to \$76.9 million for the nine months ended September 30, 2018 compared to the same period in 2017. The increase was mainly driven by higher sales commission expense, increased headcount and compensation expenses, the majority of which related to the expansion of our medical education and training organization as well as the hiring of additional product managers to support the successful launch of new products, and higher costs associated with tradeshow and meetings primarily due to the earlier timing of a major U.S. tradeshow in 2018. These increases were partially offset by a \$0.6 million decrease in stock-based compensation expense and lower legal and audit fees.

Research and Development

R&D expenses decreased \$0.4 million to \$8.8 million, or 8.3% of revenue, for the nine months ended September 30, 2018 compared to the same period in 2017. The decrease was primarily driven by a \$0.4 million decrease in stock-based compensation expense.

Intangible Amortization

Intangible amortization expense, excluding the amounts reported in cost of goods sold for product technology intangible assets, remained consistent at \$2.4 million for both the nine months ended September 30, 2018 and 2017.

Income Taxes

	Nine Months Ended	
	September 30,	September 30,
	2018	2017
	(In thousands)	
Loss before income taxes	\$ (23,994)	\$ (24,620)
Provision (benefit) for income taxes	4	(12)
Effective tax rate	—	% —

We reported income tax expense for the nine months ended September 30, 2018 primarily related to foreign and state operations, offset by the release of ASC 740-10 (FIN 48) liabilities due to the expiration of the statute of limitations.

We reported an income tax benefit for the nine months ended September 30, 2017 primarily related to the release of ASC 740-10 (FIN 48) liabilities due to the expiration of the statute of limitations, offset by income tax related to foreign and state operations.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate rate from 35% to 21%, requires companies to pay a one-time transition tax on accumulated earnings of certain foreign subsidiaries previously deferred from tax and creates a new provision designed to tax global intangible low-taxed

income (GILTI). We are not subject to the one-time transition tax on accumulated foreign earnings or the GILTI provisions enacted by the Act because

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our foreign operations have been included in our US tax filings pursuant to an election to disregard our foreign entity for federal income tax purposes.

In addition, for all periods presented, the pretax losses incurred by the consolidated U.S. tax group received no corresponding tax benefit because we have concluded that it is more likely than not that we will be unable to realize the value of any resulting deferred tax assets.

Business Factors Affecting the Results of Operations

Special Charges and Gains

We define special charges and gains as gains or expenses for which the amount or timing can vary significantly from period to period, and for which the amounts are non-cash in nature, or the amounts are not expected to recur at the same magnitude.

We believe that identification of these special charges and gains provides important supplemental information to investors regarding financial and business trends relating to our financial condition and results of operations. Investors may find this information useful in assessing comparability of our operating performance from period to period, against the business model objectives that management has established, and against other companies in our industry.

We provide this information to investors so that they can analyze our operating results in the same way that management does and use this information in their assessment of the core business and valuation of SeaSpine.

Loss before income taxes includes the following special gains for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Special Gains:				
Gain from change in fair value of contingent consideration liabilities ⁽¹⁾	\$(176)	\$(1,242)	\$(893)	\$(897)
Total Special Gains	\$(176)	\$(1,242)	\$(893)	\$(897)

(1) Relates to the net decrease in the fair value of contingent liabilities associated with the NLT acquisition in 2016.

The items reported above are reflected in the consolidated statements of operations as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Selling, general and administrative	\$(176)	\$(1,242)	\$(893)	\$(785)
Other income	—	—	—	(112)
Total Special Gains	\$(176)	\$(1,242)	\$(893)	\$(897)

Liquidity and Capital Resources

Overview

On October 15, 2018, we sold 3,737,500 shares of our common stock in an underwritten public offering and generated approximately \$54.1 million of net proceeds, after deducting underwriting discounts and commissions and estimated offering expenses. As of September 30, 2018, we had cash and cash equivalents totaling approximately \$11.8 million, and \$15.3 million of current borrowing capacity was available under our credit facility. We believe that our cash and cash equivalents on hand, including the \$54.1 million of net proceeds generated from our recent public offering described above, and the amount currently available to us under our credit facility will be sufficient to fund our operations for at least the next twelve months.

Credit Facility

We have a \$30.0 million credit facility with Wells Fargo Bank, National Association which matures in July 2021, subject to a one-time, one-year extension at our election. In addition, at any time through July 27, 2020, we may increase the borrowing limit by up to an additional \$10.0 million, subject to us having sufficient amounts of eligible

accounts receivable and inventory and to customary conditions precedent, including obtaining the commitment of lenders to provide such additional amount. At September 30, 2018, we had \$7.3 million in outstanding borrowings under the credit facility. The borrowing capacity under the credit facility is determined monthly and is based on the amount of our eligible accounts receivable and inventory balances and qualified cash (as defined in the credit facility). Depending on the extent to which our eligible accounts receivable and inventory balances increase, our borrowing capacity could increase by as much as an additional \$3.9 million from the \$15.3 million available as of September 30, 2018 before we must maintain the minimum fixed charge coverage ratio as discussed

below. The credit facility contains various customary affirmative and negative covenants, including prohibiting us from incurring indebtedness without the lender's consent. Under the credit facility, if our Total Liquidity (as defined in the credit facility) is less than \$5.0 million, we must maintain a minimum fixed charge coverage ratio of 1.10 to 1.00 for the applicable measurement period. Our Total Liquidity was \$25.3 million at September 30, 2018, and therefore that financial covenant was not applicable at that time.

On November 2, 2018, we repaid the entire \$7.3 million of outstanding borrowings under the credit facility.

Business Combinations

In August 2016, we entered into an asset purchase agreement with NLT to acquire certain of the assets of NLT's medical device business related to the expandable interbody medical devices. We made an up-front cash payment of \$1.0 million in connection with the initial closing in September 2016 and issued 350,000 shares of our common stock in January 2017 as contingent closing consideration. At September 30, 2018, we recorded a \$2.1 million liability representing the estimated fair value of future contingent milestone payments related to the achievement of certain commercial milestones, which we anticipate will become payable at varying times between 2019 and 2023, and a \$1.3 million liability representing the estimated fair value of future contingent royalty payments based on percentages of our future net sales of certain of the products and technology we acquired, which we anticipate will be payable at varying times between 2018 and 2028. The contingent milestone payments, if any, are payable in cash or in shares of our common stock, at our election. The contingent royalty payments are payable in cash.

At The Market Program

In August 2016, we entered into an equity distribution agreement (Distribution Agreement) with Piper Jaffray & Co. (Piper Jaffray), pursuant to which we may offer and sell shares of our common stock in "at the market" (ATM) offerings (as defined in Rule 415 of the Securities Act of 1933, as amended) having an aggregate offering price up to \$25.0 million in gross proceeds from time to time through Piper Jaffray acting as sales agent. The shares offered and sold under the Distribution Agreement are covered by a registration statement on Form S-3 that was declared effective on August 24, 2016. Under the Distribution Agreement, during the nine months ended September 30, 2018, we sold 882,332 shares of common stock at an average price per share of \$10.00 and received net proceeds of approximately \$8.5 million (net of \$0.3 million of offering costs). We intend to continue using the net proceeds for general corporate purposes, including sales and marketing expenditures aimed at growing our business, research and development expenditures focused on product development, and investments in inventory and spinal instruments and sets. We have consumed the \$25.0 million in capacity under the Distribution Agreement as of September 30, 2018.

In May 2018, we entered into another equity distribution agreement with Piper Jaffray (the May 2018 Distribution Agreement), pursuant to which we may offer and sell shares of our common stock in ATM offerings having an aggregate offering price up to \$50.0 million in gross proceeds from time to time through Piper Jaffray acting as sales agent. The shares offered and sold under the May 2018 Distribution Agreement are covered by a registration statement on Form S-3 that was declared effective on August 24, 2016.

We did not sell any shares of common stock under the May 2018 Distribution Agreement during the nine months ended September 30, 2018. Future sales, if any, will depend on a variety of factors including, but not limited to, market conditions, the trading price of our common stock and our capital needs. We intend to use any net proceeds for general corporate purposes, including sales and marketing expenditures aimed at growing our business, research and development expenditures focused on product development, and investments in inventory and spinal instruments and sets.

Sale of Common Stock

On October 11, 2018, we entered into an Underwriting Agreement (Underwriting Agreement) with Wells Fargo Securities, LLC, Piper Jaffray & Co. and Cantor Fitzgerald & Co. acting as joint bookrunning managers and as representatives of the underwriters relating to the issuance and sale of 3,250,000 shares of our common stock. The price to the public in the offering was \$15.50 per share, before underwriting discounts and commissions. Under the terms of the Underwriting Agreement, we granted the underwriters an option, exercisable for 30 days, to purchase up to an additional 487,500 shares of common stock. The underwriters exercised this option and the offering closed on October 15, 2018 with the sale of 3,737,500 shares of our common stock. The net proceeds from the offering were approximately \$54.1 million, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We have used a portion of the net proceeds from this offering to repay all of our outstanding borrowings under our credit facility with Wells Fargo Bank, National Association, and we intend

to use the remaining proceeds for general corporate purposes, including general and administrative expenses, capital expenditures and general working capital purposes.

Cash and Cash Equivalents

We had cash and cash equivalents totaling approximately \$11.8 million and \$10.8 million at September 30, 2018 and December 31, 2017, respectively.

Cash Flows

	Nine Months Ended September 30,		2018 vs. 2017	
	2018	2017	% Change	
	(In thousands)			
Net cash used in operating activities	\$(8,601)	\$(4,109)	109.3	%
Net cash used in investing activities	(6,565)	(5,718)	14.8	%
Net cash provided by financing activities	16,233	11,532	40.8	%
Effect of exchange rate changes on cash and cash equivalents	(73)	418	(117.5)	%
Net change in cash and cash equivalents	\$994	\$2,123	(53.2)	%

Net Cash Used in Operating Activities

Net cash used in operating activities for the nine months ended September 30, 2018 increased by \$4.5 million compared to the same period in 2017. The increase was primarily due to 2017 performance incentive bonuses for executive management being paid in cash in 2018, whereas 2016 performance incentive bonuses for the executive team were paid via equity in lieu of cash in 2017, increased sales commission payments during the 2018 period compared to the 2017 period and increased inventory purchases and settlement of accrued expenses which increased operating cash outflows compared to the 2017 period. These changes were partially offset by changes in accounts payable which increased cash inflows due to timing of payments to suppliers.

Net Cash Used in Investing Activities

Net cash used in investing activities was \$6.6 million for the nine months ended September 30, 2018 compared to \$5.7 million for the same period in 2017. The increase was primarily due to larger investments in spinal instruments and sets to support recent spinal implant product launches.

Net Cash Provided by Financing Activities

Net cash provided by financing activities was \$16.2 million for the nine months ended September 30, 2018 and was comprised of \$8.5 million of net proceeds from the sale of shares of our common stock under the ATM equity offering program, \$7.0 million in borrowings under our revolving line of credit, \$0.5 million in proceeds from the issuance of stock under our ESPP, and \$0.9 million in proceeds from the exercise of stock options. We used \$0.6 million of cash for tax payments we made on our employees' behalf for shares we withheld from such employees on the vesting of restricted stock awards to cover statutory tax withholding requirements.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements as of September 30, 2018 that have, or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our business.

Contractual Obligations and Commitments

There have been no material changes outside the ordinary course of our business to the contractual obligations disclosed in the 2017 10-K.

Other Matters

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Critical Accounting Policies and the Use of Estimates

Our discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparing these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Significant estimates affecting amounts reported or disclosed in the consolidated financial statements include revenue recognition, allowances for doubtful accounts receivable and sales return and other credits, net realizable value of inventories, amortization periods for acquired intangible assets, estimates of projected cash flows and discount rates used to value intangible assets and test them for impairment, estimates of projected cash flows and assumptions related to the timing and probability of the product launch dates, discount rates matched to the timing of payments, and probability of success rates used to value contingent consideration liabilities from business combinations, estimates of projected cash flows and depreciation and amortization periods for long-lived assets, valuation of stock-based compensation, computation of taxes and valuation allowances recorded against deferred tax assets, and loss contingencies. These estimates are based on historical experience and on various other assumptions believed to be reasonable under the current circumstances. Actual results could differ from these estimates.

Note 2, "Summary of Significant Accounting Policies" to the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report and included in Part II, Item 8 of the 2017 10-K describe the significant accounting policies and estimates used in the preparation of our condensed consolidated financial statements. Those policies and estimates disclosed in the 2017 10-K have not materially changed.

Recently Issued Accounting Pronouncements

Information regarding new accounting pronouncements is included in Note 2, "Summary of Significant Accounting Policies," to the Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The market risk exposures described in Part II, Item 7A of the 2017 10-K have not materially changed during the nine months ended September 30, 2018.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of our management, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of the end of the period covered by this report to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) under the Exchange Act that occurred during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are subject to legal proceedings and claims in the ordinary course of business. While management presently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not materially harm our financial position, cash flows, or overall trends in results of operations, legal proceedings are subject to inherent uncertainties, and unfavorable rulings or outcomes could occur that have, individually or in aggregate, a material adverse effect on our business, financial condition or operating results. We are not currently subject to any pending material litigation, other than ordinary routine litigation incidental to our business, as described above.

ITEM 1A. RISK FACTORS

The risk factors described in the 2017 10-K have not materially changed.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer

The table below is a summary of purchases of our common stock we made during the quarter covered by this report. Other than as indicated in the table below, no such purchases were made in any other month during the quarter. We do not have any publicly announced repurchase plans or programs.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
July 1 - July 31	3,951	\$ 12.90	—	—
August 1 - August 31	432	\$ 14.10	—	—
September 1 - September 30	531	\$ 15.40	—	—

(1) These shares were surrendered to the Company to satisfy tax withholdings obligations in connection with the vesting of restricted stock awards.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

Exhibit No.	Description
10.1*	<u>Amended and Restated Credit Agreement between SeaSpine Holdings Corporation, SeaSpine Orthopedics Corporation, SeaSpine, Inc., SeaSpine Sales LLC, Theken Spine, LLC, ISOTIS Orthobiologics, Inc. and Wells Fargo Bank, National Association, as administrative agent for each member of the lender group and the bank product providers, entered into as of July 27, 2018</u>
31.1*	<u>Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2*	<u>Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1**	<u>Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2**	<u>Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS*†	XBRL Instance Document
101.SCH*†	XBRL Taxonomy Extension Schema Document
101.CAL*†	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*†	XBRL Definition Linkbase Document
101.LAB*†	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE*†	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

These certifications are being furnished solely to accompany this report pursuant to 18 U.S.C. 1350, and are not being

** filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of the registrant, whether made before or after the date hereof, regardless of any general incorporation by reference language in such filing.

† The financial information of SeaSpine Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 filed on November 6, 2018 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations, (ii) Condensed Consolidated Statements of Comprehensive Loss, (iii) the Condensed Consolidated Balance Sheets, (iv) Parenthetical Data to the Condensed Consolidated Balance Sheets, (v) the Condensed Consolidated Statements of Cash Flows, (vi) the Condensed Consolidated Statement of Equity, and (vii) Notes to Unaudited Condensed Consolidated Financial Statements, is furnished electronically herewith.

SIGNATURES

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

SEASPINE HOLDINGS CORPORATION

Date: November 6, 2018 /s/ Keith C. Valentine
Keith C. Valentine
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 6, 2018 /s/ John J. Bostjancic
John J. Bostjancic
Chief Financial Officer
(Principal Financial Officer)