DIGITAL RIVER INC /DE
Form POS AM
January 17, 2006

As filed with the Securities and Exchange Commission on January 17, 2006

Registration No. 333-118519

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Post-effective Amendment No. 1

to

FORM S-3
REGISTRATION STATEMENT

UNDER
THE SECURITIES ACT OF 1933

DIGITAL RIVER, INC.

(Exact name of issuer as specified in its charter)

Delaware	**5045**	**41-1901640**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

9625 W. 76th Street, Suite 150
Eden Prairie, Minnesota 55344
(952) 253-1234

(Address, including zip code and telephone number, including area code, of Registrant s principal executive offices)

Joel A. Ronning
Chief Executive Officer
Digital River, Inc.
9625 W. 76th Street, Suite 150
Eden Prairie, Minnesota 55344
(952) 253-1234

(Name, address, including zip code and telephone number, including area code, of agent for service)

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(415) 434-1600

Approximate date of commencement of proposed sale to the public:

as soon as practicable after the registration statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to rule 462(c) under the securities act, check the following box and list the securities act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

SUBJECT TO COMPLETION DATED JANUARY 17, 2006

PROSPECTUS

$195,000,000

Digital River, Inc.

1.25% Convertible Senior Notes due January 1, 2024 and 4,425,486 Shares of Common Stock, Subject to Adjustments, Issuable Upon Conversion of the Notes

This prospectus covers resales by selling securityholders of our 1.25% Convertible Senior Notes due January 1, 2024 and shares of our common stock into which the notes are convertible.

The notes will mature on January 1, 2024. We will pay interest on the notes on January 1 and July 1 of each year. We will make the first interest payment on January 1, 2005.

We may not redeem the notes prior to July 1, 2007. We may redeem some or all of the notes for cash on or after July 1, 2007 and prior to January 1, 2009, at 100% of their principal amount plus accrued and unpaid interest, if any, if the closing price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of mailing of the redemption notice exceeds 150% of the conversion price in effect on such trading day. We may also redeem some or all of the notes for cash (i) on January 1, 2009 at a price equal to 100.25% of the principal amount of the notes being redeemed and (ii) after January 1, 2009 at a price equal to 100% of the principal amount of the notes being redeemed, plus accrued and unpaid interest, if any, in each case. Holders may require us to repurchase for cash all or part of their notes (i) on January 1, 2009 at a price equal to 100.25% of the principal amount of the notes being repurchased and (ii) on each of January 1, 2014 and January 1, 2019 at a price equal to 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any, in each case.

The notes are convertible into our common stock, subject to the conditions described below, at an initial conversion price of $44.063 per share, subject to adjustments for certain events. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per $1,000 principal amount of notes. Holders may surrender their notes for conversion, if any of the following conditions is satisfied:

- if the price of our common stock issuable upon conversion of a note reaches a specific threshold;
- if we have called the notes for redemption;
- if the trading price of the notes falls below certain thresholds;
- if specified corporate transactions occur; or
- in connection with a transaction or event constituting a fundamental change.

Holders may require us to repurchase their notes upon the occurrence of a fundamental change in cash at 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any, plus the make whole premium, if any, payable in shares of our common stock.

The notes will be senior unsecured obligations and will rank, in right of payment, the same as all of our existing and future senior unsecured indebtedness. The notes will rank senior in right of payment to all of our subordinated indebtedness and will be effectively subordinated to any secured indebtedness.

Our common stock is quoted on The Nasdaq National Market under the symbol DRIV. The last reported sale price of our common stock on January 13, 2006 was $33.25 per share. Prior to this offering the notes have been eligible for trading in The PortalSM Market (PORTAL), a subsidiary of The Nasdaq Stock Market, Inc.

Notes sold by means of the prospectus are not expected to remain eligible for trading on the PORTAL Market. We do not intend to list the notes for trading on any national securities exchange or on the Nasdaq National Market and can give no assurances about the development of any trading market for the notes.

See Risk Factors beginning on page 4 of this prospectus to read about factors you should consider before buying the notes or our common stock.

Neither the Securities and Exchange Commission, any state securities commission nor any other regulatory authority, has approved or disapproved the securities nor have any of the foregoing authorities passed upon or endorsed the merits of this offering or the accuracy or adequacy of this prospectus or the documents incorporated by reference herein. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2006.

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Digital River is our registered trademark.

All other trademarks or trade names in this prospectus are the property of their respective owners.

SUMMARY

This summary highlights basic information about us and this offering but may not contain all information important to you. You should read the more detailed information contained in, or incorporated by reference into, this prospectus. In this prospectus, unless expressly stated otherwise or unless the context otherwise requires, Digital River, Inc., Digital River, we, us and our refer to Digital River, Inc. and its consolidated subsidiaries.

Digital River, Inc.

We are a provider of comprehensive electronic commerce outsourcing solutions. We were incorporated in February 1994 and commenced offering products for sale through our clients Web stores in August 1996. As a leading global e-commerce outsource provider, we enable our clients to access our proprietary electronic commerce system over the Internet. We have developed a technology platform that allows us to provide a suite of electronic commerce services, including Web commerce development and hosting, transaction processing, fraud prevention, digital and physical product fulfillment, export controls, tax management, multi-lingual customer service, advanced reporting and strategic marketing services. We provide an outsourcing solution that allows our clients to promote their own brands while leveraging our investment in infrastructure and technology. Some of our key clients include Allume Systems, Inc., Autodesk, Inc., Comp USA, DownloadSuperstore.com, eBay, Inc., H&R Block Inc., McAfee, Inc., Microsoft Corporation, OfficeMax Incorporated, PC Magazine, ScanSoft, Inc., Software Oasis, Inc., Symantec Corporation, Targus, Inc. and Trend Micro, Inc.

Our proprietary commerce network server technology serves as the platform for most of our solutions. Our technology incorporates custom software applications that enable Web store authoring, electronic software delivery, fraud prevention, export control, merchandising programs and online registration. Using our platform, we create Web commerce systems for our clients that replicate the look and feel of each client s Web site. End-users enter the client site and are then seamlessly transferred to our commerce server. End-users can then browse for products and make purchases online, and once purchases are made, we either deliver the products digitally to the end-user through the Internet or communicate the order through its integration into a number of third-party fulfillment agencies for physical fulfillment. We also provide transaction-processing services and collect and maintain critical information about end-users. This information can later be used by our clients to facilitate add-on or upgrade sales and for other direct marketing purposes. We actively manage direct marketing campaigns for our clients and also deliver purchase information and Web store traffic statistics to our clients through online reporting.

We were incorporated in Delaware in 1994. Our address is 9625 West 76th Street, Suite 150, Eden Prairie, Minnesota 55344, (952) 253-1234. We maintain a website at www.digitalriver.com. Information contained on, or accessed through, our website does not constitute a part of this prospectus.

The Notes

Interest	The notes bear interest at 1.25% per annum on the principal amount from June 1, 2004, payable semi-annually in arrears in cash on January 1 and July 1 of each year, beginning January 1, 2005.
Maturity date	January 1, 2024.
Conversion	The notes are convertible into shares of our common stock, subject to the conditions described herein, at an initial conversion price of $44.063 per share, subject to adjustments for certain events. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per $1,000 principal amount of notes.
	You may surrender your notes for conversion if any of the following conditions is satisfied:
	• During any fiscal quarter commencing after June 30, 2004, if the sale price of our common stock for 20 consecutive trading days in the preceding fiscal quarter is more than 130% of the conversion price per share;
	• If we have called the notes for redemption;
	• If the average of the trading prices of the notes for any 5 consecutive trading day period is less than 95% of the average of the conversion values of the notes during that period; provided, however, that no notes may be converted based on the satisfaction of this condition after January 1, 2019, if on any day during such five consecutive trading day period, the sale price of our common stock is between the conversion price and 130% of the conversion price;
	• If we make certain significant distributions to the holders of our common stock; or
	• In connection with a transaction or event constituting a fundamental change of Digital River.
	See Description of the Notes Conversion Rights.
Provisional redemption	We may not redeem the notes prior to July 1, 2007. We may redeem some or all of the notes for cash on or after July 1, 2007 and prior to January 1, 2009, at 100% of their principal amount, plus accrued and unpaid interest, if any, if the closing price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of mailing of the redemption notice exceeds 150% of the conversion price on such trading day. See Description of the Notes Provisional Redemption of Notes.
Optional redemption	We may also redeem some or all of the notes for cash (i) on January 1, 2009 at a price equal to 100.25% of the principal amount of the notes being redeemed and (ii) after January 1, 2009 at a price equal to 100% of the principal amount of the notes being redeemed, plus accrued and unpaid interest, if any, in each case. See Description of the Notes Optional Redemption of Notes.

Purchase at holder s option on specified dates	You may require us to purchase for cash all or part of your notes (i) on January 1, 2009 at a price equal to 100.25% of the principal amount of the notes being purchased and (ii) on each of January 1, 2014 and January 1, 2019 at a price equal to 100% of the principal amount of the notes being purchased, plus accrued and unpaid interest, if any, in each case. See Description of the Notes Purchase of Notes at the Option of the Holder.
Make whole premium upon a fundamental change	If a fundamental change occurs prior to January 1, 2009, we will pay a make whole premium on notes converted in connection with, or tendered for repurchase upon, a fundamental change as described below. The make whole premium will be payable in our stock (or the consideration into which our stock has been exchanged) on the repurchase date for the notes after the fundamental change, both for notes tendered for repurchase and for notes converted in connection with the fundamental change.
	The amount of the make whole premium, if any, will be based on our stock price and the effective date of the fundamental change. A description of how the make whole premium will be determined and tables showing the make whole premium that would apply at various stock prices and fundamental change effective dates based on the current conversion rate are set forth under Description of the Notes Determination of the Make Whole Premium. No make whole premium will be paid if the stock price is less than $33.13 or if the stock price exceeds $100.00.
Purchase at holder s option upon a fundamental change	You may require us to purchase your notes upon the occurrence of a fundamental change in cash at 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any, payable in cash, plus the make whole premium, if any, payable in shares of our common stock. See Description of the Notes Repurchase at the Option of a Holder Upon a Fundamental Change.
Ranking	The notes are senior unsecured obligations and rank, in right of payment, the same as all of our existing and future senior unsecured indebtedness. The notes rank senior in right of payment to all of our subordinated indebtedness and are effectively subordinated to any secured indebtedness and any indebtedness of our subsidiaries.
Use of proceeds	We will not receive any proceeds from the sale of the notes or the shares of common stock offered by this prospectus. See Selling Securityholders.

RISK FACTORS

You should carefully consider the risks described in our Annual Report on Form 10-K and incorporated herein by reference, as well as in other filings we make with the SEC and those described below before making an investment decision. These risks are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The value of the notes and our common stock could decline due to any of these risks, and you may lose all or part of your investment. This prospectus and the incorporated documents also contain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this prospectus.

Risks Related To The Notes

The notes are unsecured and contain no financial covenants.

The notes are not secured by our assets. The indenture does not restrict our ability to incur additional debt, including secured debt. The notes are effectively subordinated to any of our existing or future secured indebtedness to the extent of the assets securing that indebtedness. In addition, the indenture does not contain any financial covenants, restrict our ability to repurchase our securities, pay dividends or make restricted payments or contain covenants or other provisions to afford holders protection in the event of a transaction that substantially increases our level of indebtedness. Furthermore, the indenture contains only limited protections in the event of a fundamental change as defined below under Description of the Notes Repurchase at the Option of a Holder Upon a Fundamental Change. We could engage in many types of transactions, such as acquisitions, refinancing or recapitalizations, that could substantially affect our capital structure and the value of the notes and our common stock but would not constitute a fundamental change permitting holders to require us to repurchase their notes under the indenture.

The notes are effectively subordinated to the liabilities of our subsidiaries.

In the event of the insolvency, bankruptcy, liquidation, reorganization, dissolution or winding up of the business of any of our subsidiaries, creditors of our subsidiaries generally will have the right to be paid in full before any distribution is made to us or the holders of the notes. Accordingly, holders of the notes are effectively subordinated to the claims of our subsidiaries creditors, including trade creditors, to the extent of the assets of the indebted subsidiary. This subordination could adversely affect our ability to pay our obligations on the notes. Our subsidiaries have no obligation to pay any amounts due on the notes or to provide us with funds for our payment obligations, whether by dividends, distributions, loans or other payments.

We may be unable to finance the repurchase of the notes even if required by the holders pursuant to the indenture.

We will be required to repurchase all or a portion of the outstanding notes at the option of the holders on January 1, 2009, 2014 and 2019. In addition, upon a fundamental change, we may be required to redeem all or a portion of the outstanding notes. If a fundamental change were to occur, we may not have enough funds to pay the redemption price for all tendered notes. Any credit agreements or other agreements relating to our indebtedness may prevent us from repurchasing the notes or contain provisions that expressly prohibit the repurchase of the notes upon a fundamental change or may provide that a fundamental change constitutes an event of default under that agreement. If a fundamental change occurs at a time when we are prohibited from repurchasing or redeeming notes, we could seek the consent of our lenders to redeem the notes or could attempt to refinance this debt. If we do not obtain a consent, we could not repurchase or redeem the notes. Our failure to redeem tendered notes would constitute an event of default under the indenture, which might constitute a default under the terms of our other indebtedness. See Description of the Notes.

The contingent conversion features of the notes could result in your receiving less than the value of the common stock into which the notes are convertible.

The notes are convertible into common stock only if specified conditions are met. If the specified conditions for conversion are not met, you may not be able to receive the value of our common stock into which the notes would otherwise be convertible. Therefore, you may not be able to realize the appreciation, if any, in the value of our common stock after the issuance of the notes.

Conversion of the notes may affect the trading price of our common stock.

The conversion of some or all of the notes and any sales in the public market of our common stock issuable upon such conversion could adversely affect the market price of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could depress our common stock price.

The price of our common stock, and therefore of the notes, may fluctuate significantly, and this may make it difficult for you to resell the notes when you want or at prices you find attractive.

The price of our common stock on The Nasdaq National Market constantly changes. Because the notes are convertible into shares of our common stock, volatility in the market price for our common stock could have a similar effect on the trading price of the notes. This may result in greater volatility in the market price of the notes than would be expected for nonconvertible debt securities. The market price of our common stock has been and may continue to be subject to wide fluctuations. Fluctuations in our common stock price may be caused by a variety of factors, some of which are beyond our control:

- actual or anticipated variations in quarterly operating results and announcements of technological innovations;
- new products or services offered by us or our competitors;
- changes in financial estimates by securities analysts;
- changes in research coverage by securities analysts;
- any announcement by us of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- additions or departures of key personnel;
- sales by current holders of our common stock; and
- general conditions in, and investor sentiment regarding, electronic commerce companies generally.

Future sales of our common stock in the public market or the issuance of securities senior to our common stock could adversely affect the trading price of our common stock and the value of the notes and our ability to raise funds in new stock offerings.

Future sales of substantial amounts of our common stock or equity-related securities in the public market, or the perception that these sales could occur, could adversely affect prevailing trading prices of our common stock and the value of the notes and could impair our ability to raise capital through future offerings of equity or equity-related securities. No prediction can be made as to the effect, if any, that future sales of shares of common stock or the availability of shares of common stock for future sale, will have on the trading price of our common stock or the value of the notes.

Rating agencies may provide unsolicited ratings on the notes that could reduce the market value or liquidity of the notes and our common stock.

We have not requested a rating of the notes from any rating agency and we do not anticipate that the notes will be rated. However, if one or more rating agencies rates the notes and assigns the notes a rating lower than the rating expected by investors, or reduces their rating in the future, the market price or liquidity of the notes and our common stock could be harmed.

Provisions of the notes may inhibit potential acquisition bids for us.

Your repurchase right upon the occurrence of a fundamental change could, in some circumstances, make more difficult or discourage a potential takeover of us and, thus, removal of incumbent management.

We cannot assure you that an active trading market will develop for the notes.

Prior to this offering, the notes were traded on the PORTAL Market. Notes resold pursuant to this prospectus will cease to be traded on the PORTAL Market. We do not intend to list the notes for trading on any national securities exchange or on the Nasdaq National Market and can give no assurances about the development of any trading market for the notes.

The notes constitute a new issue of securities for which there is no established trading market. We cannot predict whether an active trading market for the notes will develop or be sustained. If an active market for the notes fails to develop or be sustained, the trading price of the notes could fall. If an active trading market were to develop, the notes could trade at prices that may be lower than the initial offering price of the notes. Whether or not the notes will trade at lower prices depends on many factors, including:

- prevailing interest rates and the markets for similar securities;
- general economic conditions; and
- our financial condition, historic financial performance and future prospects.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth the ratio of earnings to fixed charges for each of the last five years and for the nine months ended September 30, 2005 (in millions):

	Years ended December 31					Nine months ended September 30,
	2000	**2001**	**2002**	**2003**	**2004**	**2005**
Ratio of earnings to fixed charges(1)				70.5	17.6	22.0

(1) The ratio of earnings to fixed charges is computed by dividing income (loss) from operations plus fixed charges by fixed charges. Fixed charges consist of interest expense, amortization of debt issuance costs and that portion of rental payments under operating leases that we believe to be representative of interest. Earnings were insufficient to cover fixed charges in 2000 through 2002 by amounts equal to the net loss for the period.

FORWARD-LOOKING STATEMENTS

Some of the statements in this prospectus and the documents incorporated by reference are forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s results, levels of activity, performance or achievement to be materially different from any future results, levels of activity, performance or achievements expressed or implied in or contemplated by the forward-looking statements. Words such as believe, anticipate, expect, intend, plan, will, may, should, estimate, predict, pot the negative of such terms or other similar expressions, identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption Risk Factors and in the documents incorporated by reference. The forward- looking statements made in this prospectus relate only to events as of the date on which the statements are made.

USE OF PROCEEDS

We will not receive any proceeds from the sale of the notes or the shares of common stock offered by this prospectus. See Selling Securityholders.

DIVIDEND POLICY

We have never paid or declared any cash dividends on our common stock or other securities and do not anticipate paying cash dividends in the foreseeable future. We currently intend to retain all future earnings, if any, for use in the operation of our business.

DESCRIPTION OF THE NOTES

We issued the notes under an indenture dated June 1, 2004, which is referred to as the indenture. The indenture is a contract between Digital River and Wells Fargo Bank, National Association, who is serving as trustee. The following description of the terms is a summary. It summarizes only those portions of the indenture we believe are most important to your decision to invest in the notes. This section does not describe every aspect of the notes. The indenture, and not this summary, defines your rights as a holder of the notes. There may be other provisions in the indenture that are also important to you. You should read the indenture for a full description of the terms of the notes. We will provide a copy, at no charge, if you contact us. As used in this section, the words we, us, our or Digital River refer to Digital River, Inc. and its successors under the indenture and do not include any current or future subsidiary of Digital River, Inc.

General

We have issued notes in the aggregate principal amount of $195,000,000 in denominations of $1,000 or in multiples of $1,000. The notes will mature on January 1, 2024, unless earlier converted, redeemed or repurchased.

The indenture does not contain any restrictions on the payment of dividends or the repurchase of our securities or any financial covenants. The indenture contains no covenants or other provisions to afford protection to holders of notes in the event of a highly leveraged transaction or a change in control of Digital River except to the extent described under Repurchase at the Option of a Holder Upon a Fundamental Change.

The notes bear interest at the annual rate of 1.25%, which may be increased as described in Registration Rights below, from June 1, 2004. Interest is payable on January 1 and July 1 of each year, beginning January 1, 2005, subject to limited exceptions if the notes are converted or purchased prior to the interest payment date. The record dates for the payment of interest are December 15 and June 15. We may, at our option, pay interest on the notes by check mailed to the holders. However, a holder with an aggregate principal amount in excess of $2 million will be paid by wire transfer in immediately available funds upon its election if the holder has provided us with wire transfer instructions at least 10 business days prior to the payment date. Interest is computed on the basis of a 360-day year comprised of twelve 30-day months. We are not required to make any payment on the notes due on any day that is not a business day until the next succeeding business day. The payment made on the next succeeding business day will be treated as though it were paid on the original due date and no interest will accrue on the payment for the additional period of time.

We maintain an office in The City of New York where we will pay the principal of, and interest, if any, on the notes and you may present the notes for registration, transfer, exchange or conversion. This office is currently an office of the trustee. Except under limited circumstances described below, the notes are issued only in fully-registered book-entry form, without coupons, and are represented by one or more global notes. There is no service charge for any registration of transfer or exchange of notes. We or the trustee may, however, require holders to pay a sum sufficient to cover any tax or other governmental charge payable in connection with certain transfers or exchanges.

Ranking

The notes are senior unsecured obligations of Digital River and rank in right of payment the same as all of our existing and future senior unsecured indebtedness. The notes rank senior in right of payment to all of our subordinated indebtedness and are effectively subordinated to any secured indebtedness.

The notes are our exclusive obligations. Our right to receive assets of any of our subsidiaries upon their liquidation or reorganization, and the consequent right of the holders of the notes to participate in those assets, is effectively subordinated to the claims of that subsidiary s creditors, including trade creditors, except to the extent that we are recognized as a creditor of that subsidiary, in which case our claims would still be subordinate to any security interests in the assets of that subsidiary and any indebtedness of that subsidiary senior to that held by us.

The indenture does not limit the amount of additional indebtedness, including any secured indebtedness, that we may create, incur, assume or guarantee, nor does the indenture limit the amount of indebtedness and other liabilities that any of our subsidiaries may create, incur, assume or guarantee.

Conversion Rights

You may convert any portion of your notes, in whole or in part, into common stock prior to the close of business on the maturity date of the notes, subject to prior redemption of the notes, upon the satisfaction of the conditions described below. You may convert all or any portion of the principal amount of any note that is a multiple of $1,000 into our common stock at an initial conversion price of $44.063 per share. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares of common stock per $1,000 principal amount of notes, and is subject to adjustment as described below.

If any notes are converted during the period after any record date but before the next interest payment date, interest on those notes will be paid on the next interest payment date, notwithstanding such conversion, to the holder of record on the record date of those notes. However, any notes that are delivered to us for conversion after any record date but before the next interest payment date must, except as described in the next sentence, be accompanied by a payment equal to the interest payable on such interest payment date on the principal amount of notes being converted. We will not require the payment to us described in the preceding sentence (1) if we have specified a redemption date that is after a record date and on or prior to the next interest payment date, (2) if we have specified a purchase date following a fundamental change that is after a record date and on or prior to the next interest payment date or (3) only to the extent of overdue interest, if any overdue interest exists at the time of conversion with respect to such note. If you convert any notes after an interest payment date but on or before the next record date, no interest will be paid on those notes.

Holders may surrender their notes for conversion into shares of our common stock prior to stated maturity under the following circumstances:

Conversion Upon Satisfaction of Market Price Condition

You may surrender notes for conversion into our common stock on or prior to the maturity date during any fiscal quarter, if the sale price of our common stock, for each of any 20 consecutive trading days in the immediately preceding fiscal quarter, exceeds 130% of the conversion price per share of our common stock on that trading day.

For each fiscal quarter, we will determine if the notes are convertible as the result of the satisfaction of this condition in the preceding fiscal quarter and will promptly notify the trustee accordingly. The trustee will, in turn, notify the holders in each fiscal quarter as to the satisfaction of this condition.

The sale price of our common stock on any date means the closing per share sale price, or if no sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices, on that date as reported in composite transactions for the principal United States securities exchange on which our common stock is traded or, if our common stock is not listed on a United States national or regional securities exchange, as reported by the Nasdaq System or by the National Quotation Bureau Incorporated. However if Nasdaq is no longer reporting this information, or if our common stock is not quoted on Nasdaq, as available in any other over-the-counter market or, if not available in any over-the counter market, the sale price will be determined in good faith by our board of directors.

Conversion Upon Notice of Redemption

You may surrender for conversion a note called for redemption at any time prior to the close of business on the business day that is prior to the redemption date, even if it is not otherwise convertible at that time. However, if you have already delivered a purchase notice or notice of your exercise of your option to require us to repurchase your notes, you may not surrender your notes for conversion until you have withdrawn this notice in accordance with the indenture.

Conversion Upon Trading Price of Notes Falling Below a Percentage of the Conversion Value of the Notes

If, after any five consecutive trading-day period in which the average of the trading prices for the notes for this five trading-day period is less than 95% of the average of the conversion values for the notes during that period, then you may surrender notes for conversion at any time during the following five trading days; provided, however, that no notes may be converted based on the satisfaction of this condition after January 1, 2019, if, on any day during such five consecutive trading-day period, the sale price of our common stock is between the conversion price and 130% of the conversion price.

The trading price means, on any date of determination, the average of the secondary bid quotations per note obtained by the conversion agent for $2,000,000 principal amount of the notes at approximately 3:30 p.m., New York City time, on that determination date from three independent nationally recognized securities dealers that we select; provided, that if at least three such bids cannot reasonably be obtained, but two bids can reasonably be obtained, then the average of these two bids will be used; provided, further, that if at least two bids cannot reasonably be obtained, but one bid can reasonably be obtained, this one bid will be used. If the trustee cannot reasonably obtain at least one bid for $2,000,000 principal amount of the notes from a nationally recognized securities dealer, then the trading price per $1,000 principal amount of the notes will be deemed to be less than 95% of the product of the closing sale price of our common stock and the conversion rate.

The conversion value of a note means the product of the last reported bid price of our common stock on any date of determination multiplied by the conversion rate of the note in effect on that date, which is the number of shares of our common stock into which the note is convertible.

Conversion Upon Specified Corporate Transactions

Even if the market price contingency described above under Conversion of Notes Conversion Upon Satisfaction of Market Price Condition has not occurred, if we elect to distribute to all holders of our common stock:

- rights or warrants entitling them to subscribe for or purchase our common stock at less than the current market price, as defined in the indenture, on the trading day immediately preceding the declaration date for the distribution; or

- cash, debt securities or other evidence of indebtedness or other assets, which distribution, together with all other such distributions within the preceding twelve months, has a per share value exceeding 10% of the current market price of our common stock as of the trading day immediately preceding the declaration date for the distribution,

we must notify you at least 20 days prior to the ex-dividend date for this distribution. Once we have given the notice, you may surrender your notes for conversion at any time until the earlier of the close of business on the business day prior to the ex-dividend date or our announcement that the distribution will not take place.

Conversion Upon a Fundamental Change

In addition, in the event of a fundamental change, you may surrender notes for conversion at any time beginning 10 days before the anticipated effective date of the fundamental change and until 10 days after the actual effective date of the fundamental change. If you convert your notes in connection with a fundamental change, you will receive:

- the make whole premium, if any, which will be in an amount determined as set forth under Determination of the Make Whole Premium and which will be payable in shares of our common stock on the repurchase date for the notes after the fundamental change described under Repurchase at the Option of a Holder Upon a Fundamental Change; plus

- the number of shares of our common stock into which a holder s notes are convertible (if the notes are surrendered for conversion prior to the record date for receiving distributions in connection with a fundamental change, or if earlier, the effective time of the fundamental change) or the kind and amount of cash, securities and other assets or property which you would have received if you had held the number of shares of common stock into which the notes were convertible immediately prior to the transactions (if notes are surrendered for conversion after such record date or effective time, as the case may be); plus

- accrued but unpaid interest, if any, to but excluding the conversion date, which interest will be payable in cash.

Conversion Procedures

Your right to convert a note called for redemption at our option will terminate at the close of business on the business day prior to the redemption date, unless we default in making payment due upon redemption. If you have submitted your notes for repurchase upon a fundamental change, you may convert your notes only if you withdraw your repurchase notice prior to the repurchase date, as described below under Repurchase at the Option of a Holder Upon a Fundamental Change. If the notes are subject to repurchase following a fundamental change, your conversion rights with respect to the notes subject to repurchase will expire at 5:00 p.m. New York City time on the business day before the repurchase date.

The right to convert any note may be exercised:;margin-top:0pt;margin-left:0pt;;text-indent:0pt;;color:#000000;font-family:Times New Roman;font-size:10pt;font-weight:normal;font-style:normal;text-transform:none;font-variant: normal;">8,177

12,526

Non-current litigation liabilities

87,553

93,700

Other long-term liabilities

12,742

13,230

Commitments and contingencies

Stockholders’ equity:

Preferred stock, $0.001 par value; 5,000,000 shares authorized, none outstanding

—

—

Common stock, $0.001 par value; 120,000,000 shares authorized at September 30, 2015 and December 31, 2014, 52,099,475 and 47,691,744 issued and outstanding at September 30, 2015 and December 31, 2014, respectively

52

48

Additional paid-in capital

973,481

847,145

Accumulated other comprehensive loss

(11,323

)

(9,670

)

Accumulated deficit

(132,150

)

(186,938

)

Treasury stock at cost; 3,015,033 shares and 233,369 shares at September 30, 2015 and December 31, 2014, respectively

(146,077

)

(10,537

)

Total NuVasive, Inc. stockholders’ equity

683,983

640,048

Non-controlling interests

7,709

8,310

Total equity

$

691,692

$

648,358

Total liabilities and equity

$

1,271,964

$

1,343,459

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(unaudited)	2015	2014	2015	2014
Revenue	$200,538	$189,918	$595,831	$558,090
Cost of goods sold (excluding below amortization of intangible assets)	49,167	47,719	143,246	135,849
Gross profit	151,371	142,199	452,585	422,241
Operating expenses:				
Sales, marketing and administrative	111,384	113,746	342,797	348,820
Research and development	9,199	9,068	27,245	28,590
Amortization of intangible assets	3,067	3,071	9,037	10,541
Impairment of intangible assets	—	—	—	10,708
Litigation liability (gain) loss	(500)	—	(42,507)	30,000
Business transition costs	110	—	6,474	—
Total operating expenses	123,260	125,885	343,046	428,659
Interest and other expense, net:				
Interest income	362	241	1,125	691
Interest expense	(7,307)	(6,965)	(21,675)	(20,809)
Other income (expense), net	387	(2,489)	530	(2,318)
Total interest and other expense, net	(6,558)	(9,213)	(20,020)	(22,436)
Income (loss) before income taxes	21,553	7,101	89,519	(28,854)
Income tax (expense) benefit	(8,803)	(9,088)	(35,332)	4,065
Consolidated net income (loss)	$12,750	$(1,987)	$54,187	$(24,789)
Add back net loss attributable to non-controlling interests	$(210)	$(157)	$(601)	$(595)
Net income (loss) attributable to NuVasive, Inc.	$12,960	$(1,830)	$54,788	$(24,194)
Net income (loss) per share attributable to NuVasive, Inc.:				
Basic	$0.26	$(0.04)	$1.13	$(0.52)
Diluted	$0.24	$(0.04)	$1.05	$(0.52)
Weighted average shares outstanding:				
Basic	48,993	46,990	48,513	46,546
Diluted	53,199	46,990	52,202	46,546

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Consolidated net income (loss)	$12,750	$(1,987)	$54,187	$(24,789)
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities, net of tax	57	(29)	201	(103)
Translation adjustments, net of tax	(410)	(2,579)	(1,854)	(566)
Other comprehensive (loss)	(353)	(2,608)	(1,653)	(669)
Total consolidated comprehensive income (loss)	12,397	(4,595)	52,534	(25,458)
Net loss attributable to non-controlling interests	210	157	601	595
Comprehensive income (loss) attributable to NuVasive, Inc.	$12,607	$(4,438)	$53,135	$(24,863)

See accompanying Notes to Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
(unaudited)	2015	2014
Operating activities:		
Consolidated net income (loss)	$54,187	$(24,789)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	49,006	46,521
Amortization of non-cash interest	13,255	12,244
Stock-based compensation	20,570	24,779
Impairment of intangible assets	—	10,708
Deferred income taxes	37,047	—
Reserves on current assets	7,232	4,062
Other non-cash adjustments	13,127	11,317
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	2,163	(5,519)
Inventory	(19,768)	(27,190)
Prepaid expenses and other current assets	2,512	(1,837)
Accounts payable and accrued liabilities	8,828	11,485
Income taxes	(52,739)	(7,898)
Accrued royalties	(46,999)	12,450
Litigation liability	(35,333)	30,000
Accrued payroll and related expenses	(5,080)	151
Net cash provided by operating activities	48,008	96,484
Investing activities:		
Acquisitions and other investments	(1,357)	(59)
Purchases of intangible assets	(28,589)	—
Purchases of property and equipment	(59,905)	(45,692)
Proceeds from sales of property and equipment	40	—
Purchases of marketable securities	(320,177)	(177,850)
Proceeds from sales of marketable securities	272,666	142,051
Purchases of restricted investments	(62,625)	—
Proceeds from sales of restricted investments	180,694	—
Net cash used in investing activities	(19,253)	(81,550)
Financing activities:		
Incremental tax benefits related to stock-based compensation awards	15,185	—
Proceeds from the issuance of common stock	9,040	15,341
Payment of contingent consideration	(514)	(498)
Purchase of treasury stock	(52,532)	(664)
Other financing activities	(131)	(668)

Net cash (used in) provided by financing activities	(28,952)	13,511
Effect of exchange rate changes on cash	(862)	(613)
(Decrease) increase in cash and cash equivalents	(1,059)	27,832
Cash and cash equivalents at beginning of period	142,387	102,825
Cash and cash equivalents at end of period	$141,328	$130,657

See accompanying Notes to Unaudited Consolidated Financial Statements.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Description of Business

NuVasive, Inc. (the “Company” or “NuVasive”) was incorporated in Delaware on July 21, 1997, and began commercializing its products in 2001. The Company is focused on developing minimally-disruptive surgical products and procedurally-integrated solutions for the spine. NuVasive’s principal product offering includes a minimally-disruptive surgical platform called Maximum Access Surgery, or MAS®. The MAS platform combines three categories of solutions that collectively minimize soft tissue disruption during spine fusion surgery, provide maximum visualization and are designed to enable safe and reproducible outcomes for the surgeon and the patient. The platform includes proprietary software-driven nerve detection and avoidance systems, NVM5® and NVJJB®, and Intra-Operative Monitoring (“IOM”) services and support; MaXcess®, an integrated split-blade retractor system; and a wide variety of specialized implants and biologics. Many of the Company’s products, including the individual components of NuVasive’s MAS platform, can also be used in open or traditional spine surgery. The Company’s spine surgery product line offerings, which include thoracolumbar product offerings, cervical product offerings, IOM services, and disposables, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally-disruptive fashion. The Company also recently launched integrated global alignment (“iGA™”), in which products and computer assisted technology under its MAS platform help achieve more precise spinal alignment. The Company’s biologic product line offerings used to aid the spinal fusion process or bone healing process include Osteocel® Plus and Osteocel Pro allograft (donated human tissue) which are cellular matrix products containing viable mesenchymal stem cells (“MSCs”), as well as other allograft offerings, FormaGraft®, a collagen synthetic product, and AttraX®, a synthetic bone graft material. The Company continues to focus significant research and development efforts to expand its MAS product platform and advance the applications of its unique technology into procedurally-integrated surgical solutions. The Company has dedicated and continues to dedicate significant resources toward training spine surgeons around the world; both those who are new to its MAS product platform as well as previously MAS-trained surgeons attending advanced courses.

The Company’s primary business model is to loan its MAS systems to surgeons and hospitals who use those systems to perform individual procedures, with the hospitals purchasing implants, biologics and disposables in each such case. In addition, for larger customers, the Company’s proprietary nerve monitoring systems, MaXcess and surgical instrument sets are placed with hospitals for an extended period at no up-front cost to them, facilitating the hospital’s purchase of disposables for those machines from the Company. The Company also offers a range of bone allograft in patented saline packaging, disposables and spine implants, which include its branded CoRoent® products and fixation devices such as rods, plates and screws. The Company’s implants, biologics and disposables are currently sold and shipped from its primary distribution and warehousing operations facility located in Memphis, Tennessee. The Company sells MAS instrument sets, MaXcess devices and its proprietary software-driven nerve monitoring systems, however this does not make up a material part of its business.

Basis of Presentation and Principles of Consolidation

The accompanying Unaudited Consolidated Financial Statements include the financial information of the Company and its majority-owned or controlled subsidiaries, collectively referred to as either NuVasive or the Company. The Company translates the financial statements of its foreign subsidiaries using end-of-period exchange rates for assets and liabilities and average exchange rates during each reporting period for results of operations. When there is a portion of equity in an acquired subsidiary not attributable, directly or indirectly, to the respective parent entity (entity having common control), the Company records the fair value of the non-controlling interests at the acquisition date and classifies the amounts attributable to non-controlling interests separately in equity in the Company's Consolidated Financial Statements. Any subsequent changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary are accounted for as equity transactions. All significant intercompany balances and transactions have been eliminated in consolidation.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The accompanying Unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual Consolidated Financial Statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). Operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. These Unaudited Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto for the year ended December 31, 2014 included in the Company’s Annual Report on Form 10-K filed with the SEC. In the opinion of management, the Unaudited Consolidated Financial Statements include all adjustments that are of a normal and recurring nature that are necessary for the fair presentation of the Company’s financial position and of the results of operations and cash flows for the periods presented.

The Company has reclassified historically presented product offerings revenue to conform to the current year presentation. The reclassification had no impact on previously reported results of operations or financial position.

Change in Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Adopted Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update No. 2014-09, Revenue from Contracts with Customers, (“ASU 2014-09”), an updated standard on revenue recognition. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported by companies while also improving comparability in the financial statements of companies reporting using International Financial Reporting Standards or GAAP. The main purpose of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively and improve guidance for multiple-element arrangements. In July 2015, the FASB voted to approve a one-year deferral of the effective date of ASU 2014-09, which will be effective for the Company in the first quarter of fiscal year 2018 and may be applied on a full retrospective or modified retrospective approach. The FASB permits early adoption of the new standard by one year (i.e., the original effective date). The Company is evaluating the impact of implementation and transition approach of this standard on its financial statements.

Business Transition Costs

The Company incurs costs related to integration and business transition activities which include severance, relocation, consulting, and other costs directly associated to such activities. During the nine months ended September 30, 2015, the Company incurred $6.5 million of such costs, which included a $3.4 million charge associated with the resignation of the Company's former Chief Executive Officer and Chairman of the Board, which occurred in the first quarter 2015. The $3.4 million charge includes certain severance and compensation-related charges, net of certain forfeitures of previously recognized equity-based compensation.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Restructuring Charges

The Company exited its New Jersey location and terminated the respective lease to reduce its footprint on the east coast of the United States as part of a company-wide efficiency effort in order to match its business needs without adversely impacting its ability to deliver surgeon education and local customer fulfillment. As a result of this undertaking, the Company recognized restructuring and associated impairment charges of $2.3 million during the nine months ended September 30, 2015 in addition to the $6.4 million recognized during 2014. The restructuring and impairment charges mainly consist of the future rental payments through 2017, net of estimated future sublease income, and elimination of related leasehold improvements and deferred rent liabilities. These charges are recorded in sales, marketing and administrative expense in the Consolidated Statements of Operations.

As of September 30, 2015, the total recorded liability associated with this early lease termination was $3.9 million and consists of future rental payments net of estimated sublease income through 2017. The current portion of the liability is recorded within accounts payable and accrued liabilities and the long-term portion is recorded within other long-term liabilities in the Consolidated Balance Sheets at September 30, 2015.

Litigation Liability Gain (Loss)

During the nine months ended September 30, 2015, the Company recorded a litigation liability gain of $42.5 million resulting primarily from the recognition of a $56.4 million gain stemming from a favorable appeal in Phase 1 of the Medtronic litigation and a gain of $2.8 million in litigation accrual change related to the settlement of the NeuroVision trademark litigation, partially offset by litigation losses of $13.8 million in connection with the OIG investigation and $2.8 million in a general litigation matter.

Settlement of the aforementioned NeuroVision trademark litigation totaling $27.2 million was funded out of restricted cash during the third quarter 2015, and at September 30, 2015 the Company no longer maintains short-term restricted funds related to that matter.

The March 2, 2015 Court of Appeals decision in the Company’s Medtronic litigation upheld the jury’s findings of liability as to all patents, but overturned the damage award against the Company as improper, and as a result the Company was no longer required to escrow funds related to Phase 1 of that litigation matter. During the third quarter 2015, the Company transferred all of the escrow funds related to this matter, of approximately $114.1 million, from its long-term restricted cash and investments account to its unrestricted investment accounts. The Company has no restricted funds related to this matter at September 30, 2015.

See Note 11 and Note 12 to the Unaudited Consolidated Financial Statements for further discussion.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) includes unrealized gains or losses on the

Company’s marketable securities and foreign currency translation adjustments. The cumulative translation adjustments included in accumulated other comprehensive income (loss) were a net cumulative loss of $11.4 million and $9.5 million at September 30, 2015 and December 31, 2014, respectively.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Long-Lived Assets

Long-lived assets include surgical instruments, which are loaned to surgeons and hospitals who purchase implants, biologics and disposables for use in individual procedures, leasehold improvements, software, and intangible assets. The Company periodically re-evaluates the original assumptions and rationale utilized in the establishment of the carrying value and estimated lives of its long-lived assets. The criteria used for these evaluations include management’s estimate of the asset’s continuing ability to generate income from operations and positive cash flow in future periods as well as the strategic significance of the asset to the Company’s business objectives. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets, which is determined by applicable market prices when available or other methods by utilizing unobservable inputs including discounted cash flow models. See Note 3 to the Unaudited Consolidated Financial Statements for further discussion.

Inventories

The Company’s inventory consists primarily of purchased finished goods which includes specialized implants and disposables, and is stated at the lower of cost or market determined by utilizing a standard cost method which approximates the weighted average cost. The Company reviews the components of its inventory on a periodic basis for excess, obsolete or impaired inventory, and records a reserve for such identified items. The inventory reserve was $29.9 million and $22.7 million at September 30, 2015 and December 31, 2014, respectively.

2. Net Income (Loss) Per Share

The Company computes basic net income (loss) per share using the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share assumes the conversion, exercise or issuance of all potential common stock equivalents, unless the effect of inclusion would be anti-dilutive. Common stock equivalents include the Company’s stock options, employee stock purchase plan (“ESPP”), restricted stock units (“RSUs”), including those with performance conditions, warrants, and the shares to be issued upon the conversion of the Senior Convertible Notes (see Note 6 to the Unaudited Consolidated Financial Statements).

The following table sets forth the computation of basic and diluted earnings or (loss) per share attributable to the Company:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2015	2014	2015	2014
Numerator:				
Net income (loss) available to the Company	$12,960	$(1,830)	$54,788	$(24,194)

Denominator for basic and diluted net (loss) income per share:				
Weighted average common shares outstanding for basic	48,993	46,990	48,513	46,546
Dilutive potential common stock outstanding:				
Stock options and ESPP	895	—	1,224	—
RSUs	1,129	—	1,127	—
Warrants	417	—	139	—
Senior Convertible Notes	1,765	—	1,199	—
Weighted average common shares outstanding for diluted	53,199	46,990	52,202	46,546
Basic net income (loss) per share attributable to the Company	$0.26	$(0.04)	$1.13	$(0.52)
Diluted net income (loss) per share attributable to the Company	$0.24	$(0.04)	$1.05	$(0.52)

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following weighted outstanding common stock equivalents were not included in the calculation of net income (loss) per diluted share because their effects were anti-dilutive:

(in thousands)	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Stock options, ESPP, and RSUs	13	8,777	53	8,999
Warrants	—	9,553	6,369	9,553
Senior Convertible Notes	—	9,553	—	9,553
Total	13	27,883	6,422	28,105

3. Financial Instruments and Fair Value Measurements

The Company invests its excess cash in certificates of deposit, corporate notes, commercial paper, U.S. government treasury securities and securities of government-sponsored entities. The Company classifies all such securities as available-for-sale as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value with the unrealized gains and losses reported as a component of other comprehensive income in equity until realized. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other income or expense on the Consolidated Statements of Operations and a new accounting cost basis for the security is established in the period in which it occurs. The Company reviews its investments if there is an indicator of possible other-than-temporary impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company’s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. As of September 30, 2015, the Company had no investments that were in a significant unrealized loss position and no impairment charges were recorded during the periods presented. Interest and dividends on securities classified as available-for-sale are also included in interest income on the Consolidated Statements of Operations. Realized gains and losses and interest income related to marketable securities were immaterial during all periods presented.

The Company maintains an investment policy that requires a diversified investment portfolio in terms of types, maturities, and credit exposure, and invests with institutions that have high credit quality. Annually, the Company reassesses the investment policy to ensure it is reflective of current markets and conditions. The Company does not currently hold financial instruments for speculative purposes.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The composition of marketable securities is as follows:

(in thousands, except years)	Contractual Maturity (in years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2015:					
Classified as current assets					
Corporate notes	Less than 1	$ 103,840	$ 27	$ (10)	$ 103,857
Securities of government-sponsored entities	Less than 1	65,503	9	(3)	65,509
U.S. government treasury securities	Less than 1	7,506	3	—	7,509
Certificates of deposit	Less than 1	3,671	—	—	3,671
Commercial paper	Less than 1	15,491	—	—	15,491
Short-term marketable securities		196,011	39	(13)	196,037
Classified as non-current assets					
Certificates of deposit	1 to 2	8,106	—	—	8,106
Securities of government-sponsored entities	1 to 2	46,624	38	(2)	46,660
U.S. government treasury securities	1 to 2	11,042	4	(1)	11,045
Corporate notes	1 to 2	47,948	48	(14)	47,982
Long-term marketable securities		113,720	90	(17)	113,793
Total marketable securities at September 30, 2015		$ 309,731	$ 129	$ (30)	$ 309,830
December 31, 2014:					
Classified as current assets					
Certificates of deposit	Less than 1	$ 282	$ —	$ —	$ 282
Corporate notes	Less than 1	129,037	8	(105)	128,940
Commercial paper	Less than 1	11,290	—	—	11,290
U.S. government treasury securities	Less than 1	1,500	1	—	1,501
Securities of government-sponsored entities	Less than 1	78,333	12	(29)	78,316
Short-term marketable securities		220,442	21	(134)	220,329
Classified as non-current assets					
Corporate notes	1 to 2	14,082	—	(13)	14,069
Securities of government-sponsored entities	1 to 2	28,996	—	(23)	28,973
Long-term marketable securities		43,078	—	(36)	43,042
Classified as restricted investments					
U.S. government treasury securities	Less than 2	51,331	13	(13)	51,331
Securities of government-sponsored entities	Less than 2	42,862	2	(54)	42,810
Restricted investments		94,193	15	(67)	94,141

Total marketable securities at December 31, 2014	$357,713	$ 36	$ (237)	$357,512

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Foreign Currency and Derivative Financial Instruments

The Company translates the financial statements of its foreign subsidiaries using end-of-period exchange rates for assets and liabilities and average exchange rates during each reporting period for results of operations.

Some of the Company's reporting entities conduct a portion of their business in currencies other than the entity's functional currency. These transactions give rise to receivables and payables that are denominated in currencies other than the entity's functional currency. The value of these receivables and payables is subject to changes in currency exchange rates from the point at which the transactions are originated until the settlement in cash. Both realized and unrealized gains and losses in the value of these receivables and payables are included in the determination of net income (loss). Net foreign currency exchange gains (losses), which includes gains and losses from derivative instruments, were $0.4 million and $0.4 million, for the three and nine months ended September 30, 2015, respectively, and $(2.6) million and $(2.5) million for the three and nine months ended September 30, 2014, respectively, and are included in other income (expense) in the Consolidated Statements of Operations.

The Company maintains a foreign currency risk management strategy that uses derivative instruments to protect against fluctuations in earnings and cash flows that may rise from volatility in currency exchange rates. The Company uses foreign currency forward exchange contracts to hedge the currency exchange rate exposure from short-term intercompany receivables and payables denominated in a currency other than the reporting entity's functional currency. Realized and unrealized gains or losses forward contracts are included in the determination of net income as the forward contracts are not designated for hedge accounting under ASC Topic 815, Derivatives and Hedging. The foreign currency forward contracts effectively lock in the exchange rate at which the specific intercompany receivables and payables will be settled, so that gains or losses on the forward contracts offset the gains or losses from changes in the value of the underlying receivables and payables. The forward contracts are generally settled monthly. As of September 30, 2015 a notional principal amount of $16.8 million in foreign currency forward contracts was outstanding to hedge currency risk relative to the Company's foreign receivables and payables. The Company did not have notional principal amounts outstanding as of September 30, 2014.

The Company's currency exposures vary, but are primarily concentrated in the pound sterling, the euro, the Australian dollar, the Singapore dollar, and the yen. The Company will continuously monitor the costs and the impact of foreign currency risks upon the financial results as part of the Company's risk management program. The Company does not use derivative financial instruments for speculation or trading purposes or for activities other than risk management. The Company does not require and is not required to pledge collateral for these financial instruments and does not carry any master netting arrangements to mitigate the credit risk.

The following table summarizes the fair values of derivative instruments at September 30, 2015 and December 31, 2014:

	Asset Derivatives	Liability Derivatives

(in thousands)	Balance Sheet Location	Fair Value September 30, 2015	December 31, 2014	Balance Sheet Location	Fair Value September 30, 2015	December 31, 2014
Derivative instruments not designated as cash flow hedges						
Forward exchange contracts	Other current assets	$ —	$ —	Other current liabilities	*	*
Total derivatives		$ —	$ —		*	*

*De minimus amount recognized in the hedge relationship.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes the effect of derivative instruments on the Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and September 30, 2014:

	Three Months Ended September 30, 2015		Three Months Ended September 30, 2014	
(in thousands)	Location of (Gain)/Loss Recognized in Income	Amount of (Gain)/Loss Recognized in Income	Location of (Gain)/Loss Recognized in Income	Amount of (Gain)/Loss Recognized in Income
Derivative instruments not designated as cash flow hedges				
Forward exchange contracts	Other (income) expense	$ 79	Other (income) expense	$ —
Total derivatives		$ 79		$ —

	Nine Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
(in thousands)	Location of (Gain)/Loss Recognized in Income	Amount of (Gain)/Loss Recognized in Income	Location of (Gain)/Loss Recognized in Income	Amount of (Gain)/Loss Recognized in Income
Derivative instruments not designated as cash flow hedges				
Forward exchange contracts	Other (income) expense	$ (1,585)	Other (income) expense	$ —
Total derivatives		$ (1,585)		$ —

Fair Value Measurements

The Company measures certain assets and liabilities in accordance with authoritative guidance which requires fair value measurements be classified and disclosed in one of the following three categories:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

Assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurements. The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels for certain assets or liabilities within the fair value hierarchy. The Company did not have any transfers of assets and liabilities between the levels of the fair value measurement hierarchy during the three and nine months ended September 30, 2015 or September 30, 2014, respectively.

The carrying amounts of certain financial instruments such as cash equivalents, accounts receivable, prepaid expenses, other current assets, accounts payable, accrued expenses, and other current liabilities as of September 30, 2015 and December 31, 2014 approximate their related fair values due to the short-term maturities of these instruments. The carrying values of the Company's capital lease obligations approximate their related fair values as of September 30, 2015 and December 31, 2014.

The fair value, based on a quoted market price (Level 1), of the Company's outstanding Senior Convertible Notes due 2017 at September 30, 2015 and December 31, 2014 was approximately $506.3 million and $516.1 million, respectively. The carrying value of the Company's Senior Convertible Notes is discussed in Note 6 to the Unaudited Consolidated Financial Statements.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The fair values of the Company's assets and liabilities, including cash equivalents, marketable securities, restricted investments, derivatives, and contingent considerations are measured at fair value on a recurring basis, and are determined under the fair value categories as follows:

(in thousands)	Total	Quoted Price in Active Market (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2015:				
Money market funds	$37,582	$ 37,582	$ —	$ —
Certificates of deposit	11,777	11,777	—	—
Corporate notes	157,290	—	157,290	—
Commercial paper	15,491	—	15,491	—
U.S. government treasury securities	18,554	18,554	—	—
Securities of government-sponsored entities	112,169	—	112,169	—
Total assets	$352,863	$ 67,913	$ 284,950	$ —
December 31, 2014:				
Money market funds	$39,963	$ 39,963	$ —	$ —
Certificates of deposit	282	282	—	—
Corporate notes	143,009	—	143,009	—
Commercial paper	11,290	—	11,290	—
U.S. government treasury securities	52,831	52,831	—	—
Securities of government-sponsored entities	150,101	—	150,101	—
Total assets	$397,476	$ 93,076	$ 304,400	$ —
Acquisition-related liabilities, current	$(644)	$ —	$ —	$ (644)
Total liabilities	$(644)	$ —	$ —	$ (644)

Contingent Consideration Liability

The fair value of contingent consideration liabilities assumed by a business combination is determined using a discounted cash flow model, the significant inputs of which are not observable in the market. The fair value of such contingent considerations is recorded as part of the purchase consideration of the acquisition. The key assumptions in applying this approach are the projections associated with the applicable milestone, the interest rate and the related probabilities and payment structure in the contingent consideration arrangement. Contingent consideration arrangements assumed by an asset purchase will be measured and accrued when such contingency is resolved.

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):

	Nine Months Ended September 30,	
(in thousands)	2015	2014
Fair value measurement at beginning of period	$644	$1,212
Change in fair value measurement included in operating expenses	(36)	8
Contingent consideration paid or settled	(608)	(608)
Fair value measurement at end of period	$—	$612

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Non-financial assets and liabilities measured on a nonrecurring basis

Certain non-financial assets and liabilities are measured at fair value, usually with Level 3 inputs including discounted cash flow method or cost method, on a nonrecurring basis in accordance with authoritative guidance. In general, non-financial assets, including intangible assets and property and equipment, are measured at fair value when there is an indication of impairment and are recorded at fair value only when any impairment is recognized.

During the first quarter of 2014, the Company exited a portion of its New Jersey property and subsequently, in the first quarter of 2015, made a decision to terminate the respective lease. Based on management's assessment, during the nine months ended September 30, 2015 and September 30, 2014, the Company recognized impairment charges of $0.9 million and $2.2 million, respectively, in leasehold improvement write-offs associated with the lease termination.

See Note 1 to the Unaudited Consolidated Financial Statements for further discussion on impairment analysis and leasehold related charges.

4. Goodwill and Intangible Assets

Goodwill and intangible assets consisted of the following:

(in thousands, except years)	Weighted-Average Amortization Period	Gross	Accumulated	Intangible Assets,
September 30, 2015:	(in years)	Amount	Amortization	net
Intangible assets subject to amortization:				
Developed technology	9	$79,008	$ (34,602)	$44,406
Manufacturing know-how and trade secrets	12	21,812	(12,928)	8,884
Trade name and trademarks	11	9,500	(4,868)	4,632
Customer relationships	8	44,500	(26,872)	17,628
Total intangible assets subject to amortization	10	$154,820	$ (79,270)	$75,550
Intangible assets not subject to amortization:				
In-process research and development				$10,640

Goodwill	$ 154,324

December 31, 2014:	Weighted-Average Amortization Period (in years)	Gross Amount	Accumulated Amortization	Intangible Assets, net
Intangible assets subject to amortization:				
Developed technology	9	$79,008	$ (27,760)	$51,248
Manufacturing know-how and trade secrets	12	21,879	(11,640)	10,239
Trade name and trademarks	11	9,500	(4,264)	5,236
Customer relationships	8	43,153	(23,961)	19,192
Total intangible assets subject to amortization	10	$153,540	$ (67,625)	$85,915
Intangible assets not subject to amortization:				
In-process research and development				$ 10,640
Goodwill				$ 154,443

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Total expense related to the amortization of intangible assets, which is recorded in both cost of goods sold and operating expenses in the Consolidated Statements of Operations, was $4.0 million and $3.1 million for the three months ended September 30, 2015 and September 30, 2014, respectively, and $11.7 million and $10.5 million for the nine months ended September 30, 2015 and September 30, 2014, respectively. Intangible assets acquired in a business combination that are used for in-process research and development activities are considered indefinite lived until the completion or abandonment of the associated research and development efforts. Upon reaching the end of the relevant research and development project, the Company will amortize the acquired in-process research and development over its estimated useful life or expense the acquired in-process research and development should the research and development project be unsuccessful with no future alternative use. Intangible assets acquired in an asset purchase that are used for in-process research and development are expensed as incurred.

The Company made a payment of $27.4 million during the nine months ended September 30, 2015 associated with the intangible assets which were accrued for as of December 31, 2014 in accounts payable and accrued liabilities.

Total future amortization expense related to intangible assets subject to amortization at September 30, 2015 is set forth in the table below:

(in thousands)	
Remaining 2015	$3,858
2016	15,392
2017	12,187
2018	11,676
2019	10,322
2020	9,911
Thereafter through 2027	12,204
Total future amortization expense	$75,550

5. Business Combinations

The Company has completed acquisitions that were not considered individually or collectively material to the overall Consolidated Financial Statements or the results of the Company’s operations. These acquisitions have been included in the Consolidated Financial Statements from the respective dates of the acquisitions. The Company recognizes the assets acquired, liabilities assumed, and any non-controlling interest at fair value at the date of acquisition. Certain acquisitions contained contingent consideration arrangements that required the Company to assess the acquisition date fair value of the contingent consideration liabilities, which was recorded as part of the purchase consideration of the acquisition with subsequent fair value adjustments to the contingent consideration reflected in the line items of the Consolidated Statements of Operations commensurate with the nature of the contingent consideration.

Investment in Progentix Orthobiology B.V.

In 2009, the Company completed the purchase of 40% of the capital stock of Progentix Orthobiology B.V. (“Progentix”), a company organized under the laws of the Netherlands, from existing shareholders (the “Progentix Shareholders”) pursuant to a Preferred Stock Purchase Agreement for $10.0 million in cash (the “Initial Investment”). As of September 30, 2015, NuVasive has loaned Progentix cumulatively $5.3 million at an interest rate of 6% per year. NuVasive is not obligated to provide additional funding.

Concurrently with the Preferred Stock Purchase Agreement, NuVasive, Progentix and the Progentix Shareholders entered into an Option Purchase Agreement (as amended, the “Option Agreement”), whereby NuVasive was obligated under certain circumstances, and had the option under other circumstances, to purchase the remaining 60% of capital stock of Progentix (the “Remaining Shares”) from its shareholders for an amount up to $35.0 million, subject to certain reductions. The Option Agreement expired unexercised in 2013. Also, concurrently with the Preferred Stock Purchase Agreement, NuVasive and Progentix entered into a Distribution Agreement (as amended, the “Distribution Agreement”), whereby Progentix appointed NuVasive as its exclusive distributor for certain Progentix products. The Distribution Agreement is in effect for a term of ten years unless terminated earlier in accordance with its terms.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In accordance with authoritative guidance, the Company has determined that Progentix is a variable interest entity (“VIE”), as it does not have the ability to finance its activities without additional subordinated financial support and its equity investors will not absorb their proportionate share of expected losses and will be limited in the receipt of the potential residual returns of Progentix. Additionally, pursuant to this guidance, NuVasive is considered a primary beneficiary as NuVasive has both the power to direct the economically significant activities of Progentix and the obligation to absorb losses of, or the right to receive benefits from, Progentix. Accordingly, the financial position and results of operations of Progentix have been included in the Company’s consolidated financial statements from the date of the Initial Investment. The liabilities recognized as a result of consolidating Progentix do not represent additional claims on the Company’s general assets. The creditors of Progentix have claims only on the assets of Progentix, which are not material, and the assets of Progentix are not available to NuVasive.

The equity interests in Progentix not owned by the Company, which includes shares of both common and preferred stock, are reported as non-controlling interests on the consolidated balance sheet of the Company. The preferred stock represents 18% of the non-controlling equity interests and provides for a cumulative 8% dividend, if and when declared by Progentix’s Board of Directors. As the rights of the preferred stock are substantially the same as those of the common stock, the preferred stock is classified as non-controlling interest and shares in the allocation of the losses incurred by Progentix. Losses incurred by Progentix are charged to the Company and to the non-controlling interest holders based on their ownership percentage.

Total assets and liabilities of Progentix included in the accompanying Consolidated Balance Sheets are as follows:

(in thousands)	September 30, 2015	December 31, 2014
Total current assets	$ 416	$ 839
Identifiable intangible assets, net	13,585	13,935
Goodwill	12,654	12,654
Other long-term assets	1	1
Accounts payable and accrued expenses	570	542
Deferred tax liabilities, net	2,770	2,770
Non-controlling interests	7,709	8,310

The following is a reconciliation of equity (net assets) attributable to the non-controlling interests:

(in thousands)	Nine Months Ended September 30, 2015	2014
Non-controlling interests at beginning of period	$8,310	$9,086

Less: Net loss attributable to the non-controlling interests	601	595
Non-controlling interests at end of period	$7,709	$8,491

Impulse Monitoring, Inc. and Physician Practices

The Company maintains contractual relationships with several physician practices ("PCs") which were inherited through the 2011 acquisition of Impulse Monitoring, Inc. Under the respective contracts' terms, respective PCs provide physician oversight services associated with the IOM service offerings. The Company provides management services to these PCs including all non-medical services, management reporting, billing and collections of all charges for medical services provided as well as administrative support. In turn, the PCs pay the Company a monthly management fee for these services. In accordance with authoritative guidance, the Company has determined that the PCs are VIEs and the Company has controlling financial interests in the PCs as it has both the power to direct the economically significant activities of the PCs, and the obligation to absorb losses of, or the right to receive benefits from, the PCs. Therefore, the accompanying Consolidated Financial Statements include the accounts of the PCs from the date of acquisition. During the periods presented, the result of PCs was immaterial to our financials. The creditors of the PCs have claims only on the assets of the PCs, which are not material, and the assets of the PCs are not available to the Company.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. Senior Convertible Notes

The carrying values of the Company’s Senior Convertible Notes are as follows:

(in thousands)	September 30, 2015	December 31, 2014
2.75% Senior Convertible Notes due 2017:		
Principal amount	$ 402,500	$ 402,500
Unamortized debt discount	(30,015)	(41,754)
Total Senior Convertible Notes	$ 372,485	$ 360,746

2.75% Senior Convertible Notes due 2017

In June 2011, the Company issued $402.5 million principal amount of Senior Convertible Notes with a stated interest rate of 2.75% and a maturity date of July 1, 2017 (the “2017 Notes”). The net proceeds from the offering, after deducting initial purchasers’ discounts and costs directly related to the offering, were approximately $359.2 million. The 2017 Notes may be settled in cash, stock, or a combination thereof, solely at the Company’s discretion. It is the Company’s current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of the Company’s common stock. The initial conversion rate of the 2017 Notes is 23.7344 shares per $1,000 principal amount, which is equivalent to a conversion price of approximately $42.13 per share, subject to adjustments. The Company uses the treasury share method for assumed conversion of the 2017 Notes to compute the weighted average shares of common stock outstanding for diluted earnings per share. The Company also entered into transactions for convertible note hedge (the “2017 Hedge”) and warrants (the “2017 Warrants”) concurrently with the issuance of the 2017 Notes.

The cash conversion feature of the 2017 Notes (the “Embedded Conversion Derivative”) required bifurcation from the 2017 Notes and was initially accounted for as a derivative liability and debt discount of $88.9 million upon issuance of the 2017 Notes without authorization of issuing additional common stock for the conversion. Upon obtaining stockholder approval for the additional authorized shares of the Company’s common stock, the derivative liability was reclassified to stockholders’ equity, which resulted in recognizing cumulatively $39.5 million in other income for change in fair value measurement and $49.4 million in additional paid-in-capital during 2011. The debt discount of $88.9 million is recognized as interest expense using an effective interest rate of 8.0% over the term of the 2017 Notes. The interest expense recognized on the 2017 Notes during the three months ended September 30, 2015 includes $2.8 million and $4.0 million for the contractual coupon interest and the accretion of the debt discount, respectively. The interest expense recognized on the 2017 Notes during the nine months ended September 30, 2015 includes $8.3 million and $11.7 million for the contractual coupon interest and the accretion of the debt discount, respectively. During the three months ended September 30, 2014, interest expense recognized on the 2017 Notes includes $2.8 million and $3.7 million for the contractual coupon interest and the accretion of the debt discount, respectively. The interest expense recognized on the 2017 Notes during the nine months ended September 30, 2014 includes $8.3

million and $10.9 million for the contractual coupon interest and the accretion of the debt discount, respectively. Interest on the 2017 Notes began accruing upon issuance and is payable semi-annually.

Prior to January 1, 2017, holders may convert their 2017 Notes only under the following conditions: (a) during any calendar quarter beginning October 1, 2011, if the reported sale price of the Company’s common stock for at least 20 days out of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than 130% of the conversion price on each applicable trading day; (b) during the five business day period in which the trading price of the 2017 Notes falls below 98% of the product of (i) the last reported sale price of the Company’s common stock and (ii) the conversion rate on that date; and (c) upon the occurrence of specified corporate events, as defined in the 2017 Notes. From January 1, 2017 and until the close of business on the second scheduled trading day immediately preceding July 1, 2017, holders may convert their 2017 Notes at any time (regardless of the foregoing circumstances). The Company may not redeem the 2017 Notes prior to maturity. Other than restrictions relating to certain fundamental changes and consolidations, mergers or asset sales and customary anti-dilution adjustments, the 2017 Notes do not contain any financial covenants and do not restrict the Company from paying dividends or issuing or repurchasing any of its other securities. The Company is unaware of any current events or market conditions that would allow holders to convert the 2017 Notes.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2017 Hedge

In connection with the offering of the 2017 Notes, the Company entered into the 2017 Hedge with the initial purchasers and/or their affiliates (the “2017 Counterparties”) entitling the Company to purchase up to 9,553,096 shares of the Company’s common stock at an initial stock price of $42.13 per share, each of which is subject to adjustment. The cost of the 2017 Hedge was $80.1 million and accounted for as derivative assets upon issuance of the 2017 Notes. Upon obtaining stockholder approval for the additional authorized shares of the Company’s common stock, the derivative asset was reclassified to stockholders’ equity, which resulted in recognizing cumulatively $37.1 million in other expense for the change in fair value measurement and $43.0 million in additional paid-in-capital during 2011. The 2017 Hedge will expire on July 1, 2017. The 2017 Hedge is expected to reduce the potential equity dilution upon conversion of the 2017 Notes if the daily volume-weighted average price per share of the Company’s common stock exceeds the strike price of the 2017 Hedge. An assumed exercise of the 2017 Hedge by the Company is considered anti-dilutive since the effect of inclusion would always be anti-dilutive with respect to the calculation of diluted earnings per share.

2017 Warrants

The Company sold warrants to the 2017 Counterparties to acquire up to 477,654 shares of the Company’s Series A Participating Preferred Stock at an initial strike price of $988.51 per share, subject to adjustment. Each share of Series A Participating Preferred Stock is convertible into 20 shares of the Company’s common stock, or up to 9,553,080 common shares in total. The 2017 Warrants will expire on various dates from September 2017 through January 2018 and may be settled in cash or net shares. It is the Company’s current intent and policy to settle all conversions in shares of the Company’s common stock. The Company received $47.9 million in cash proceeds from the sale of the 2017 Warrants, which was recorded in additional paid-in-capital. The 2017 Warrants could have a dilutive effect on the Company’s earnings per share to the extent that the price of the Company’s common stock during a given measurement period exceeds the strike price of the 2017 Warrants. The Company uses the treasury share method for assumed conversion of its 2017 Warrants to compute the weighted average common shares outstanding for diluted earnings per share.

7. Stock-Based Compensation

The Company estimates the fair value of stock options issued under its equity incentive plans and shares issued to shareowners under its employee stock purchase plan using a Black-Scholes option-pricing model on the date of grant. The Black-Scholes option-pricing model incorporates various and highly sensitive assumptions including expected volatility, expected term and risk-free interest rates. The expected volatility is based on the historical volatility of the Company’s common stock over the most recent period commensurate with the estimated expected term of the Company’s stock options and ESPP which is derived from historical experience. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield in effect at the time of grant. The Company has never declared or paid dividends and has no plans to do so in the foreseeable future. The fair value of restricted stock units (“RSUs”) including performance RSU (“PRSUs”) with pre-defined performance criteria is based on the stock price on the date of grant whereas the expense for PRSU with pre-defined performance criteria is adjusted with probability of achievements at each period end. The fair value of the PRSUs that are earned based on the achievement of pre-defined market conditions for total shareholder return (“TSR PRSUs”) is estimated on the date of grant using a Monte Carlo valuation model. The key assumptions in applying this model are an expected volatility and a risk-free interest rate. The fair value of equity instruments that are expected to vest are recognized and amortized on an accelerated basis over the requisite service period.

The Company is required to estimate at the grant date the value of awards that are anticipated to be forfeited prior to their vesting, and thereafter, adjusts the forfeiture rate estimates as necessary through the vesting date so that full compensation cost is recognized only for awards that vest. The Company assesses the reasonableness of the estimated forfeiture rate at least annually, with any change to be made on a cumulative basis in the period the estimated forfeiture rates change. The Company considered its historical experience of pre-vesting forfeitures on awards by each homogenous group of shareowners as the basis to arrive at its estimated annual pre-vesting forfeiture rates for RSUs.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The compensation cost that has been included in the Consolidated Statements of Operations for all stock-based compensation arrangements was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Sales, marketing and administrative expense	$6,725	$7,668	$19,448	$23,105
Research and development expense	288	471	920	1,417
Cost of goods sold	64	92	202	257
Stock-based compensation expense before taxes	7,077	8,231	20,570	24,779
Related income tax benefits	(2,831)	(3,292)	(8,228)	(9,912)
Stock-based compensation expense, net of taxes	$4,246	$4,939	$12,342	$14,867

At September 30, 2015, there was $44.0 million of unamortized compensation expense for stock options, restricted stock units and performance-based restricted stock units to be recognized over a weighted average period of 2.7 years.

Stock Options and Purchase Rights

The weighted average assumptions used to estimate the fair value of stock purchase rights under the ESPP are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
ESPP				
Volatility	40 %	43 %	43 %	46 %
Expected term (years)	1.3	1.3	1.3	1.3
Risk free interest rate	0.2%	0.2 %	0.2%	0.2 %
Expected dividend yield	— %	— %	— %	— %

Under the terms of the ESPP, shareowners can elect to have up to 15% of their annual compensation, up to a maximum of $21,250 per year, withheld to purchase shares of NuVasive's common stock for a purchase price equal to 85% of the lower of the fair market value per share (at closing) of NuVasive common stock on (i) the commencement date of the two-year or six-month offering period (depending on the purchase period enrolled), or (ii) the respective purchase date.

The Company has not granted any options since 2011.

The Company issued approximately 0.7 million and 2.9 million shares of common stock, before net share settlement, upon the exercise of outstanding stock options during the three and nine months ended September 30, 2015, respectively, and issued approximately 1.0 million shares of common stock upon the exercise of outstanding stock options during the year ended December 31, 2014.

Restricted Stock Units

RSUs represent a right to receive shares of common stock at a future date determined in accordance with the terms and conditions of a participant's award agreement (issued under either our 2004 Amended and Restated Equity Incentive Plan (as previously amended, the "2004 EIP") or the 2014 Equity Incentive Plan of NuVasive, Inc. (the "2014 EIP")). No exercise price or other monetary payment is required for receipt of RSUs or the shares issued in settlement of the respective award; instead, consideration is furnished in the form of the participant's service to the Company. The Company has granted time-based RSUs with graded vesting terms of up to four years. The Company has also granted PRSUs with up to five year graded or cliff vesting terms (in each case, with service through the date of vesting being required) and for which the ultimate issuance amount is determined by the Company's Compensation Committee upon its certification of Company performance against a pre-determined matrix, including revenue targets, total shareholder return, or earnings per share over pre-determined periods of time. Share payout levels range from 0 to 250% depending on the respective terms of an award.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company issued approximately 0.1 million shares and approximately 1.4 million shares of common stock, before net share settlement, upon vesting of RSUs (including PRSUs) during the three and nine months ended September 30, 2015, respectively, and issued approximately 1.4 million shares of common stock in settlement of RSUs (including PRSUs) upon their vesting during the year ended December 31, 2014.

8. Income Taxes

Income taxes are determined using an estimated annual effective tax rate applied against income, and then adjusted for the tax impacts of certain significant and discrete items. For the nine months ended September 30, 2015, the Company treated the tax impact related to the following as discrete events for which the tax effect was recognized separately from the application of the estimated annual effective tax rate: adjustments in valuation allowances, losses associated with our global initiative, nondeductible compensation, return to provision adjustments, period interest on uncertain tax benefits and disqualifying dispositions of qualified stock grants. The Company's effective tax rate recorded for the nine months ended September 30, 2015 was 39%.

In accordance with the disclosure requirements as described in ASC Topic 740, Income Taxes, the Company has classified unrecognized tax benefits as non-current income tax liabilities, or a reduction in non-current deferred tax assets, unless expected to be paid within one year. The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. In connection with the filing of the 2014 U.S. federal income tax return, the Company reconsidered certain tax positions, which resulted in a decrease to its gross uncertain tax benefits. The Company does not anticipate there will be a significant change in unrecognized tax benefits within the next 12 months.

(in thousands)	September 30, 2015	December 31, 2014
Gross unrecognized tax benefits at beginning of period	$ 12,372	$ 4,504
Increases in tax positions for prior years	270	5,294
Decreases in tax positions for prior years	(2,944)	-
Increases in tax positions for current year relating to ongoing operations	176	2,574
Gross unrecognized tax benefits period end	$ 9,874	$ 12,372

Of the $9.9 million of gross unrecognized tax benefits, $3.6 million, if recognized, would reduce the Company's income tax expense and effective tax rate.

The only active income tax audit being conducted as of September 30, 2015 is with the state of New York. With few exceptions, the Company is subject to tax examinations by U.S. federal, state and non-U.S. taxing authorities for all years due to loss and tax credit carryforwards. The Company believes that adequate provisions have been recorded for adjustments that may result from tax examinations. The outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company’s tax audits are resolved in a manner not consistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs, though the potential impact on the Consolidated Statements of Operations would not be expected to be material.

9. Business Segment, Product and Geographic Information

The Company operates in one segment based upon the Company’s organizational structure, the way in which the operations are managed and evaluated by the chief operating decision maker (“CODM”) and the lack of availability of discrete financial information. The Company’s CODM reviews revenue at the product line offering level, and manufacturing, operating income and expenses, and net income at the Company wide level to allocate resources and assess the Company’s overall performance. The Company shares common, centralized support functions, including finance, human resources, legal, information technology, and corporate marketing, all of which report directly to the CODM. Accordingly, decisions regarding the Company’s overall operating performance and allocation of Company resources are assessed on a consolidated basis. The Company believes it is appropriate to operate as one reporting segment. The Company has disclosed the revenues for each of its product line offerings to allow the reader of the financial statements the ability to gain some transparency into the operations of the Company.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company operates under two distinct product line offerings for revenue: spine surgery products, and biologics. The Company's spine surgery product line offerings, which include thoracolumbar product offerings, cervical product offerings, IOM services, and disposables, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally-disruptive fashion. The Company's biologics product line offerings includes allograft (donated human tissue), FormaGraft (a collagen synthetic product), Osteocel Plus and Osteocel Pro (each an allograft cellular matrix containing viable mesenchymal stem cells, or MSCs), and AttraX (a synthetic bone graft material), all of which are used to aid the spinal fusion or bone healing process.

Revenue by product line offerings was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Spine surgery products	$168,168	$157,286	$497,194	$463,132
Biologics	32,370	32,632	98,637	94,958
Total Revenue	$200,538	$189,918	$595,831	$558,090

Revenue and property and equipment, net, by geographic area were as follows:

	Revenue				Property and Equipment, Net	
	Three Months Ended September 30,		Nine Months Ended September 30,		September 30,	December 31,
(in thousands)	2015	2014	2015	2014	2015	2014
United States	$176,371	$164,805	$524,320	$490,274	$111,979	$105,022
International (excludes Puerto Rico)	24,167	25,113	71,511	67,816	28,495	23,543
Total	$200,538	$189,918	$595,831	$558,090	$140,474	$128,565

10. Commitments

Licensing and Purchasing Agreements

As of September 30, 2015, the Company has obligations under certain consultancy arrangements to pay up to approximately $23.3 million in the aggregate in the event that specified revenue-based milestones are achieved prior to 2024. Any such payment will be made in a combination of cash and the Company's common shares as provided in the agreements. Any payments in satisfaction of theses contingent obligations are considered a cost of goods sold and are recognized as and if milestones are achieved. In early 2014, the Company paid $6.2 million in aggregate – $3.0 million in cash and $3.2 million in common shares – in connection with these agreements. There was an immaterial amount of accrued liabilities on the Consolidated Balance Sheets associated with these payments as of September 30, 2015 and December 31, 2014.

Executive Severance Plans

The Company is party to certain agreements with its key executives that provide for certain payments if an executive is terminated for reasons other than cause, as defined in those agreements. At September 30, 2015, the maximum future contractual commitments for such key executives were approximately $24.4 million, excluding the acceleration of equity vesting, which is called for in certain circumstances by the applicable agreements.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. Contingencies

The Company is subject to potential liabilities under government regulations and various claims and legal actions that are pending or may be asserted from time-to-time. These matters arise in the ordinary course and conduct of the Company's business and include, for example, commercial, intellectual property, environmental, securities and employment matters. The Company intends to continue to defend itself vigorously in such matters. Furthermore, the Company regularly assesses contingencies to determine the degree of probability and range of possible loss for potential accrual in its financial statements. In the first quarter of 2015 and during the nine months ended September 30, 2015, the Company had a gain of $56.4 million related to a litigation accrual change resulting from the legal proceedings in Phase 1 of the Medtronic litigation whereby the damages award by the jury was overturned, and a gain of $2.8 million in litigation accrual change related to settlement of the NeuroVision trademark litigation. These amounts were offset by a litigation charge of $13.8 million related to the Office of the Inspector General of the U.S. Department of Health and Human Services ("OIG") investigation and a $2.8 million litigation charge in a general litigation matter. Refer to the subsequent section herein titled "Legal Proceedings" for further information.

An estimated loss contingency is accrued in the Company's financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Based on the Company's assessment, it has adequately accrued an amount for contingent liabilities currently in existence. The Company does not accrue amounts for liabilities that it does not believe are probable or that it considers immaterial to its overall financial position. Litigation is inherently unpredictable, and unfavorable resolutions could occur. As a result, assessing contingencies is highly subjective and requires judgment about future events. The amount of ultimate loss may exceed the Company's current accruals, and it is possible that its cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Legal Proceedings

Medtronic Sofamor Danek USA, Inc. Litigation

In August 2008, Warsaw Orthopedic, Inc., Medtronic Sofamor Danek USA, Inc. and other Medtronic related entities (collectively, "Medtronic") filed a patent infringement lawsuit against the Company in the United States District Court for the Southern District of California (the "Medtronic Litigation"), alleging that certain of the Company's products or methods, including the XLIF® procedure, infringe, or contribute to the infringement of, twelve U.S. patents assigned or licensed to Medtronic. Three of the patents were later withdrawn by Medtronic, leaving nine purportedly infringed patents. The Company brought counterclaims against Medtronic alleging infringement of certain of the Company's patents.

The case has been administratively broken into several phases.

The first phase ("Phase 1") of the case included three Medtronic patents and one Company patent. The initial trial on the first phase of the case concluded on September 20, 2011 in the U.S. District Court for the Southern District of California, and a jury delivered an unfavorable verdict against the Company with respect to the three Medtronic patents and a favorable verdict with respect to the one Company patent at issue, including a monetary damages award of approximately $101.2 million to Medtronic (the “2011 verdict”). Medtronic’s subsequent motion for a permanent injunction was denied by the District Court. On May 15, 2013, the District Court granted the parties’ joint motion to dismiss claims relating to one of the three Medtronic patents pursuant to a settlement agreement, leaving two Medtronic patents remaining in the litigation. On June 11, 2013, the District Court granted the parties ongoing royalties with respect to the two Medtronic patents and the one Company patent remaining in the first phase of the case (the “June 2013 ruling”).

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Both parties filed appeals to the U.S. Court of Appeals for the Federal Circuit. On March 2, 2015, the Court of Appeals issued a decision upholding the jury's findings of liability as to all patents, but overturning the damage award against the Company as improper ("March 2nd Court of Appeals Decision"). The case has been remanded back to the District Court for further proceedings to determine a proper damages award, and a retrial has been scheduled on this phase of the litigation for April 2016. As a result of the affirmation of the infringement and remand for a new trial on damages, the Company assessed the existing liability under the loss contingency framework and – in accordance with applicable accounting guidance – believes the most appropriate accrual estimate within the possible range dictated by such guidance is $87.6 million. This amount represents liability for the infringement of the two Medtronic patents for infringing products at historically supplied rates from the date of infringement to the current period. The liability does not include an accrual for lost profits or convoyed products. A liability associated with this matter has been recorded in non-current litigation liabilities. In prior periods, the Company recorded the respective liabilities (as estimated) in non-current litigation liabilities and the accrued royalties in accrued liabilities. The Company does not agree with the previously-ruled royalty rates, and intends to rigorously pursue appropriate rates during the new trial on damages. Nonetheless, in the interim, the Company has applied the previously-ruled royalty rates when calculating the appropriate estimate. As a result of the adjustment, the Company recorded an adjustment of $56.4 million as a gain in its Consolidated Statements of Operations during the first quarter 2015.

On March 19, 2012, in connection with these proceedings, the Company entered into an escrow arrangement and transferred $113.3 million of cash into a restricted escrow account to secure the amount of judgment, plus prejudgment interest, during pendency of the appeal. As a result of the March 2nd Court of Appeals Decision, the parties agreed to release all of the escrow funds related to this matter back to the Company. During the three months ended September 30, 2015, the Company transferred all of the funds in escrow related to this matter, approximately $114.1 million, from long-term restricted cash and investments into its unrestricted investment accounts.

In accordance with the authoritative guidance on the evaluation of loss contingencies, during the year ended December 31, 2011, the Company recorded an accrual of $101.2 million for the 2011 verdict. In addition, the Company accrued royalties at the royalty rates stated in the 2011 verdict on sales subsequent to the 2011 verdict and through March 31, 2013. After the June 2013 ruling, the Company (i) began accruing ongoing royalties on sales at the royalty rates stated in the June 2013 ruling, and (ii) recorded a charge of approximately $7.9 million to account for the difference between using the royalty rates stated in the 2011 verdict and those in the June 2013 ruling on sales through March 31, 2013. Based on the June 2013 ruling, the Company agreed to escrow funds to secure accrued royalties as well as future ongoing royalties. However, in light of the March 2nd Court of Appeals Decision, escrowed funds have been released to the Company and, absent a court order the Company is no longer required to escrow such funds until damages are ultimately determined. Additionally, the Company has modified its accrual from the 2011 verdict as a result of the March 2nd Court of Appeals Decision as previously discussed.

With respect to the favorable verdict delivered regarding the one Company patent litigated to verdict, the jury awarded the Company monetary damages of approximately $0.7 million for reasonable royalty damages. In accordance with the authoritative guidance on the evaluation of gain contingencies, this amount has not been recorded at September 30, 2015. Additionally, the June 2013 ruling determined the ongoing royalty rate to be paid to the Company by Medtronic for its post-verdict sales of the one Company patent. Consistent with the treatment afforded the $0.7 million damage award, no amount has been recorded for royalty revenue as of September 30, 2015.

The second phase of the case involved one Medtronic cervical plate patent. On April 25, 2013, the Company and Medtronic entered into a settlement agreement fully resolving the second phase of the case. The settlement also removed from the case the cervical plate patent that was part of the first phase. As part of the settlement, the Company received a broad license to practice (i) the Medtronic patent that was the sole subject of the second phase of the litigation, (ii) the Medtronic cervical plate patent that was part of the first phase of the litigation, and (iii) each of the Medtronic patent families that collectively represent the vast majority of Medtronic's patent rights related to cervical plate technology. In exchange for these license rights, the Company made a one-time payment to Medtronic of $7.5 million, which amount will be fully offset against any damage award ultimately determined to be owed by the Company in connection with a final resolution of the first phase of the litigation. In addition, Medtronic will receive a royalty on certain cervical plate products sold by the Company, including the Helix® and Gradient® lines of products. As a result of this settlement, all current patent disputes between the parties related to cervical plate technology have been resolved.

NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In August 2012, Medtronic filed additional patent claims in the U.S. District Court for the Northern District of Indiana alleging that various Company spinal implants (including its CoRoent® XL family of spinal implants) infringe Medtronic's U.S. Patent No. 8,021,430, that the Company's Osteocel Plus bone graft product infringes Medtronic's U.S. Patent No. 5,676,146, ("146 Patent") and that the Company's XLIF procedure and use of MaXcess IV retractor during the XLIF procedure infringe methodology claims of Medtronic's U.S. Patent No. 8,251,997. The case, which is referred to herein as the third phase of the Medtronic litigation, was later transferred to the Southern District of California, and, on March 7, 2013, the Company counterclaimed alleging infringement by Medtronic of the Company's U.S. Patent Nos. 8,000,782 (systems and related methods for performing surgical procedures), 8,005,535 (systems and related methods for performing surgical procedures), 8,016,767 (a surgical access system including a tissue distraction assembly and a tissue retraction assembly), 8,192,356 (a system for accessing a surgical target site and related methods, involving an initial distraction system, among other things), 8,187,334 (spinal fusion implant), 8,361,156 (spinal fusion implant), D652,922 (dilator design) ("922 Patent"), and D666,294 (dilator design). On July 25, 2013, Medtronic amended its complaint to add a charge of infringement of its U.S. Patent No. 8,444,696. The District Court has stayed litigation of a number of Medtronic and Company patents currently subject to reexamination or review proceedings conducted by the Patent Office. Both parties brought motions for summary judgment addressing the remaining patents, and Medtronic's motion was granted, but the District Court has not yet issued a final decision regarding NuVasive's motion. No trial date has been set in this third phase of the litigation. At September 30, 2015, the probable outcome of this litigation cannot be determined, nor can the Company estimate a range of potential loss. In accordance with the authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this litigation.

Trademark Infringement Litigation

On September 25, 2009, Neurovision Medical Products, Inc. (NMP) filed suit against the Company in the U.S. District Court for the Central District of California (Case No. 2:09-cv-06988-R-JEM) alleging trademark infringement and unfair competition. NMP sought cancellation of NuVasive's "NeuroVision" trademark registrations, injunctive relief and damages based on NMP's common law use of the "NeuroVision" mark. The matter was tried in October 2010 and an unfavorable jury verdict was delivered against the Company. The verdict awarded damages to NMP of $60.0 million. NuVasive appealed the judgment, and during pendency of the appeal, NuVasive was required to escrow funds totaling $62.5 million. In September 2012, the Court of Appeals reversed and vacated the judgment and ordered the case back to the District Court for a new trial before a different judge. As a result, the full $62.5 million was released from escrow and returned to the Company. Retrial of the matter began on March 25, 2014, and on April 3, 2014, a jury returned a verdict in favor of NMP on its claims against the Company in the amount of $30.0 million. On September 4, 2014, the Company filed a notice of appeal. The Court entered judgment and ordered a permanent injunction on September 24, 2014, enjoining the Company's future use of the NeuroVision trademark to market or promote its products. The Court also entered an order canceling the Company's NeuroVision trademark registrations, but that order was stayed pending the appeal process. On December 2, 2014, the Court denied NMP's motion for attorneys' fees, costs, and prejudgment interest, and NMP filed a notice of appeal on December 17, 2014. The appeals were consolidated on February 2, 2015. Subsequent to June 30, 2015, but prior to the filing of the Company's second quarter Form 10-Q filing, the Company agreed to settle all outstanding matters with NMP for $27.2 million. The Company adjusted its litigation accrual from $30.0 million to $27.2 million at June 30, 2015, which was recorded in short-term liabilities commensurate with the restricted assets. The $2.8 million gain resulting from the litigation accrual adjustment was recorded in the Consolidated Statement of Operations during the three months ended June 30, 2015. The Company previously escrowed funds totaling $32.5 million to secure the amount of judgment, and cover potential attorney’s fees and costs. Those funds accrued interest and were included in short-term restricted cash and investments in the Consolidated Balance Sheets until funding of the settlement which occurred during the three months ended September 30, 2015. At September 30, 2015, the Company had no remaining liability or restricted cash related to this matter.

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NUVASIVE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Securities Litigation

On August 28, 2013, a purported securities class action lawsuit was filed in the U.S. District Court for the Southern District of California naming the Company and certain of its current and former executive officers for allegedly making false and materially misleading statements regarding the Company's business and financial results, specifically relating to the purported improper submission of false claims to Medicare and Medicaid. The complaint asserts a putative class period stemming from October 22, 2008 to July 30, 2013. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder and seeks unspecified monetary relief, interest, and attorneys' fees. On February 13, 2014, the lead plaintiff ("Plaintiff") filed an Amended Class Action Complaint for Violations of the Federal Securities Laws. The District Court granted the Company's motion to dismiss the Amended Complaint and ordered Plaintiff to amend its complaint. Plaintiff filed a Second Amended Complaint on September 8, 2014, and the District Court once again granted the Company's motion to dismiss the complaint with leave to amend. On December 23, 2014 Plaintiff filed a Third Amended Complaint. The Company filed a motion to dismiss, and while the Company's motion was pending, Plaintiff sought leave to file a Fourth Amended Complaint. The Company moved to dismiss the Fourth Amended Complaint. On August 28, 2015, the District Court issued an order granting the Company's motion to dismiss the Fourth Amended Complaint with leave to amend. On September 11, 2015, Plaintiff filed a Fifth Amended Complaint. At September 30, 2015, the probable outcome of this litigation cannot be determined, nor can the Company estimate a range of potential loss. In accordance with authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this litigation.

12. Regulatory Matters

In 2013, the Company received a federal administrative subpoena from the Office of the Inspector General of the U.S. Department of Health and Human Services (OIG) in connection with an investigation into possible false or otherwise improper claims submitted to Medicare and Medicaid. The subpoena sought discovery of documents for the period January 2007 through April 2013. In April 2015, the Company announced that it had reached an agreement in principle with the U.S. Department of Justice ("DOJ") to settle this matter, and in July 2015, the Company entered into a definitive settlement agreement. Under the terms of the agreement, the Company agreed to pay $13.5 million plus fees and accrued interest of approximately $0.3 million to resolve this matter. The settlement was not an admission of liability or wrongdoing by the Company, and the Company was not required to enter into a corporate integrity agreement with the OIG as part of the settlement. In accordance with the authoritative guidance on the evaluation of loss contingencies, the Company recorded a $13.8 million litigation charge related to this matter, which is included in the Consolidated Statements of Operations during the nine months ended September 30, 2015, and funded $12.9 million of the settlement during the third quarter 2015, with $0.9 million payable outstanding in the settlement included in current liabilities as of September 30, 2015.

On August 31, 2015, the Company received a civil investigative demand ("CID") issued by the DOJ pursuant to the federal False Claims Act. The CID requires the delivery of a wide range of documents and information related to an investigation by the DOJ concerning allegations that the Company assisted a physician group customer in submitting improper claims for reimbursement and made improper payments to the physician group in violation of the Anti-Kickback Statute. The Company is cooperating with the DOJ. No assurance can be given as to the timing or outcome of this investigation. At September 30, 2015, the probable outcome of this matter cannot be determined, nor can the Company estimate a range of potential loss. In accordance with authoritative guidance on the evaluation of loss contingencies, the Company has not recorded an accrual related to this matter.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements May Prove Inaccurate

This quarterly report on Form 10-Q (“Quarterly Report”), including the following discussion and analysis, may contain forward-looking statements that involve risks, uncertainties, assumptions and other factors which, if they do not materialize or prove correct, could cause our results to differ from historical results or those expressed or implied by such forward-looking statements. In some cases, you can identify these forward-looking statements by words like “may”, “will”, “should”, “could”, “expects”, “plans”, “anticipates”, “believes”, “estimates”, “predicts”, “potential”, “intends” the negative of those words and other comparable words). Forward-looking statements include, but are not limited to, statements about:

- our intentions, beliefs and expectations regarding our expenses, sales, operations and future financial performance;
- our operating results;
- our plans for future products and enhancements of existing products;
- anticipated growth and trends in our business;
- the timing of and our ability to maintain and obtain regulatory clearances or approvals;
- our belief that our cash and cash equivalents and investments will be sufficient to satisfy our anticipated cash requirements;
- our expectations regarding our revenues, customers and distributors;
- our beliefs and expectations regarding our market penetration and expansion efforts;
- our expectations regarding the benefits and integration of recently-acquired businesses and our ability to make future acquisitions and successfully integrate any such future-acquired businesses;
- our anticipated trends and challenges in the markets in which we operate; and
- our expectations and beliefs regarding and the impact of investigations, claims and litigation.

These statements are not guarantees of future performance or events. Our actual results may differ materially from those discussed here. The potential risks and uncertainties that could cause actual results to differ materially include, but are not limited to those set forth under the heading “Risk Factors”, and elsewhere in this Quarterly Report, and similar discussions in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the year ended December 31, 2014. We assume no obligation to update any forward looking statements to reflect new information, future events or circumstances or otherwise.

This information should be read in conjunction with the consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report and with Management’s Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2014 contained in our 2014 Annual Report on Form 10-K.

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Overview

We are the third largest global medical device company in the global spine market, focused on developing minimally-disruptive surgical products and procedurally-integrated solutions for the spine. Our currently-marketed product portfolio is focused on applications for spine fusion surgery (including biologics), a combined market estimated to be approximately $9.0 billion globally in 2015. Our principal product offering includes a minimally-disruptive surgical platform called Maximum Access Surgery, or MAS. The MAS platform combines three categories of solutions that collectively minimize soft tissue disruption during spine fusion surgery, provide maximum visualization and are designed to enable safe and reproducible outcomes for the surgeon and the patient. The platform includes our proprietary software-driven nerve detection and avoidance systems, NVM5 and NVJJB, and Intra-Operative Monitoring, or IOM support; MaXcess, an integrated split-blade retractor system; and a wide variety of specialized implants and biologics. Many of our products, including the individual components of our MAS platform, can also be used in open or traditional spine surgery. Our spine surgery product line offerings, which include products for the thoracolumbar and the cervical spine, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally-disruptive fashion. We also recently launched iGA, in which products and computer assisted technology under our MAS platform help achieve more precise spinal alignment. Our biologic product line offerings used to aid the spinal fusion process or bone healing include Osteocel Plus and Osteocel Pro allograft (donated human tissue), which are cellular matrix products containing viable mesenchymal stem cells, or MSCs, as well as other allograft offerings, FormaGraft, a collagen synthetic product, and AttraX, a synthetic bone graft material. We continue to focus significant research and development efforts to expand our MAS product platform and advance the applications of our unique technology into procedurally-integrated surgical solutions. We have dedicated and continue to dedicate significant resources toward training spine surgeons around the world; both those who are new to our MAS product platform as well as previously MAS-trained surgeons attending advanced training courses.

Our MAS platform, with the unique advantages provided by our nerve monitoring systems, enables an innovative lateral procedure known as eXtreme Lateral Interbody Fusion, or XLIF, in which surgeons access the spine for a fusion procedure from the side of the patient’s body, rather than from the front or back. Our MaXcess instruments provide access to the spine in a manner that affords direct visualization and our nerve monitoring systems assist surgeons in avoiding critical nerves.

To date, the majority of our revenues are derived from the sale of implants, biologics and disposables and we expect this trend to continue for the foreseeable future. Our primary business model is to loan our MAS systems to surgeons and hospitals that use those systems to perform individual procedures, with the hospitals purchasing implants, biologics and disposables in each such case. In addition, for larger customers, our proprietary nerve monitoring systems, MaXcess and surgical instrument sets are placed with hospitals for an extended period at no up-front cost to them, facilitating the hospital’s purchase of disposables for those machines from us. Our implants, biologics and disposables are currently sold and shipped from our primary distribution and warehousing operations facility located in Memphis, Tennessee. We generally recognize revenue for implants, biologics and disposables upon receiving acknowledgement of a purchase order and upon completion of delivery. We sell MAS instrument sets, MaXcess devices, and our proprietary software-driven nerve monitoring systems, however this does not make up a material part of our business.

The majority of our operations are located and the majority of our sales have been generated in the United States. We sell our products in the United States through a sales force comprised of exclusive independent sales agents and directly-employed sales employees, who we refer to as “shareowners”, both engaged to sell only NuVasive products. Our sales force provides a delivery and consultative service to our surgeon and hospital customers and is compensated based on sales and product placements in their territories. Sales force commissions are reflected in our statement of operations in the sales, marketing and administrative expenses line. We continue to invest in our expansion of international sales efforts with the focus on European, Asian and Latin American markets. Our international sales force is comprised of directly-employed sales shareowners as well as exclusive distributors and independent sales agents.

During the nine months ended September 30, 2015, specifically in the first quarter, our former Chief Executive Officer and Chairman of the Board resigned from such roles, and in the second quarter our Board of Directors appointed Gregory T. Lucier, a Director since 2013, to be our Chief Executive Officer and Chairman of the Board.

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Results of Operations

Revenue

	September 30,			
(in thousands, except %)	2015	2014	$ Change	% Change
Three Months Ended				
Revenue				
Spine surgery products	$168,168	$157,286	$10,882	7 %
Biologics	32,370	32,632	(262)	(1)%
Total revenue	$200,538	$189,918	$10,620	6 %
Nine Months Ended				
Revenue				
Spine surgery products	$497,194	$463,132	$34,062	7 %
Biologics	98,637	94,958	3,679	4 %
Total revenue	$595,831	$558,090	$37,741	7 %

Our spine surgery product line offerings, which include products for the thoracolumbar product offerings, cervical product offerings, IOM services, and disposables, are primarily used to enable access to the spine and to perform restorative and fusion procedures in a minimally-disruptive fashion. Our biologic product line offerings include allograft (donated human tissue), FormaGraft (a collagen synthetic product), Osteocel Plus and Osteocel Pro (each an allograft cellular matrix containing viable mesenchymal stem cells, or MSCs), and AttraX (a synthetic bone graft material), all of which are used to aid the spinal fusion or bone healing process.

The continued adoption of minimally invasive procedures for spine has led to the expansion of our procedure volume. In addition, increased market acceptance in our international markets contributed to the increase in revenues for the periods presented. We expect continued adoption of our innovative minimally invasive procedures and deeper penetration into existing accounts and international markets as our sales force executes on our strategy of selling the full mix of our products and services. However, the continued consolidation and increased purchasing power of our hospital customers and group purchasing organizations, the continued existence of physician-owned distributorships, recent changes in the public and private insurance markets regarding reimbursement, and ongoing policy and legislative changes in the United States have created less predictability in the lumbar portion of the spine market and have limited the domestic spine market's procedural growth rate. Accordingly, we believe that our growth in revenue in 2015 will come primarily from share gains in the shift toward less invasive spinal surgery and international growth.

Our total revenues increased $10.6 million and $37.7 million during the three and nine months ended September 30, 2015, respectively, representing total revenue growth of 6% and 7%, respectively, compared to the same periods in 2014.

Revenue from our spine surgery products increased $10.9 million and $34.1 million, or 7%, during the three and nine months ended September 30, 2015, compared to the same periods in 2014. For both periods this increase resulted from an increase in volume of approximately 10%, offset by unfavorable changes in both price, of 1%, and foreign currency fluctuation of approximately 3% for the three month period and 2% for the nine month period, compared to the same periods in 2014.

Revenue from biologics increased $3.7 million, or 4%, during the nine months ended September 30, 2015 compared to the same period in 2014, which was primarily due to an increase in volume.

Cost of Goods Sold, Excluding Below Amortization of Intangible Assets

	September 30,			
(in thousands, except %)	2015	2014	$ Change	% Change
Three Months Ended				
Cost of goods sold (excluding below amortization of intangible assets)	$49,167	$47,719	$1,448	3 %
% of total revenue	25 %	25 %		
Nine Months Ended				
Cost of goods sold (excluding below amortization of intangible assets)	$143,246	$135,849	$7,397	5 %
% of total revenue	24 %	24 %		

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Cost of goods sold consists primarily of raw materials, labor and overhead associated with product manufacturing, purchased goods, inventory-related costs and royalty expense, as well as the cost of providing IOM services, which includes personnel and physician oversight costs. We primarily procure and manufacture our goods in the United States, and accordingly, foreign currency fluctuations have not materially impacted our cost of goods sold.

Cost of goods sold as a percentage of revenue remained consistent in the three and nine months ended September 30, 2015 compared to the same periods in 2014. The improvements in gross margin, as a result of expiring royalty obligations for certain product lines, were partially offset by obsolescence of existing products due to our new product launch and sales price decreases.

On a long-term basis, we expect cost of goods sold, as a percentage of revenue, to decrease moderately.

Operating Expenses

(in thousands, except %)	Three Months Ended September 30, 2015 Operating expense	% of revenue	Three Months Ended September 30, 2014 Operating expense	% of revenue	$ Change	% Change
Sales, marketing and administrative	$111,384	56 %	$113,746	60 %	(2,362)	(2)%
Research and development	9,199	5 %	9,068	5 %	131	1 %
Amortization of intangible assets	3,067	2 %	3,071	2 %	(4)	— %
Impairment of intangible assets	—	— %	—	— %	—	*
Litigation liability (gain) loss	(500)	— %	—	— %	(500)	*
Business transition costs	110	— %	—	— %	110	*

(in thousands, except %)	Nine Months Ended September 30, 2015 Operating expense	% of revenue	Nine Months Ended September 30, 2014 Operating expense	% of revenue	$ Change	% Change
Sales, marketing and administrative	$342,797	58 %	$348,820	63 %	(6,023)	(2)%
Research and development	27,245	5 %	28,590	5 %	(1,345)	(5)%
Amortization of intangible assets	9,037	2 %	10,541	2 %	(1,504)	(14)%
Impairment of intangible assets	—	— %	10,708	2 %	(10,708)	*
Litigation liability (gain) loss	(42,507)	(7)%	30,000	5 %	(72,507)	(242)%
Business transition costs	6,474	1 %	—	— %	6,474	*

Sales, Marketing and Administrative

Sales, marketing and administrative expenses consist primarily of compensation costs, commissions and training costs for shareowners engaged in sales, marketing and customer support functions. The expense also includes distributor commissions, freight expenses, surgeon training costs, depreciation expense for property and equipment such as surgical instrument sets, and administrative expenses for both shareowners and third party service providers.

Sales, marketing and administrative expenses decreased by $2.4 million or 2% during the three months ended September 30, 2015, compared to the same period in 2014, primarily related to decreases in facilities expense related to the 2014 charge resulting from exiting the majority of our New Jersey lease prior to the end of the lease term, shareowner stock-based and salesforce commission based compensation, and shareowner travel expenses, partially offset by increases in distributor commissions as a function of the increase in revenue and international expansion, and expenses for third party service providers.

Sales, marketing and administrative expenses decreased by $6.0 million or 2% during the nine months ended September 30, 2015, compared to the same period in 2014, primarily related to decreases in shareowner stock-based and salesforce commission based compensation, shareowner travel expenses, freight expenses, legal expenses, and a decrease in facilities expense related to the 2014 charge resulting from exiting the majority of our New Jersey lease prior to the end of the lease term. These decreases were partially offset by increases in distributor commissions as a function of the increase in revenue and international expansion, depreciation of loaned systems and instrument sets, and expenses for third party service providers.

As a percentage of revenue, sales, marketing and administrative expenses decreased during the three and nine months ended September 30, 2015 compared to the same periods in 2014 due to improved operating efficiencies. On a long-term basis, we expect total sales, marketing and administrative costs, as a percentage of revenue, to decrease moderately. To date, foreign currency fluctuations have not materially impacted our sales, marketing, and administrative expense.

Research and Development

Research and development expense consists primarily of product research and development, clinical trial and study costs, regulatory and clinical functions, and compensation and other shareowner related expenses. In the last several years, we have introduced numerous new products and product enhancements that have significantly expanded our MAS platform, enhanced the applications of the XLIF procedure, and expanded our offering of cervical products. We have also acquired complementary and strategic assets and technology, particularly in the area of spine surgery products. We continue to invest in research and development programs.

Research and development expense decreased by $1.3 million or 5%, but remained comparatively consistent as a percentage of revenue during the nine months ended September 30, 2015 compared to the same period in 2014. The decrease is primarily related to decreases in shareowner travel expenses, shareowner stock-based compensation, and reduction in expense related to prototypes for the new product launch that occurred in the current year. These decreases were partially offset by increases in equipment expenses related to iGA software development projects and other research and development projects and grants.

Research and development costs as a percentage of revenue have remained relatively flat throughout the nine months ended September 30, 2015 compared to the same periods in 2014. However, on a long-term basis, excluding unique items, we expect total research and development costs as a percentage of revenue to increase moderately in support of our ongoing development and regulatory approval efforts.

Amortization of Intangible Assets

Amortization expense decreased $1.5 million or 14% during the nine months ended September 30, 2015, compared to the same period in 2014, primarily due to certain intangible assets reaching the end of their useful lives.

Litigation Liability Gain (Loss)

Litigation liability gain of $42.5 million for the nine months ended September 30, 2015 primarily related to the recognition of a $56.4 million gain stemming from a favorable appeal in Phase 1 of the Medtronic litigation, which revised the award for lost profits and convoyed sales, and a gain of $2.8 million in litigation accrual change related to the settlement of the NeuroVision trademark litigation reducing the accrual from $30.0 million to $27.2 million. The litigation liability gains were partially offset by litigation liability losses of $13.8 million in connection with the OIG investigation and $2.8 million in a general litigation matter. See Note 11 and Note 12 to the Unaudited Consolidated Financial Statements for further discussion.

Business Transition Costs

The Company incurs costs related to integration and business transition activities which include severance, relocation, consulting, and other costs directly related to such activities. During the nine months ended September 30, 2015, the Company incurred $6.5 million of such costs, which included a $3.4 million charge in the first quarter associated with the resignation of the Company’s former Chief Executive Officer and Chairman of the Board. The $3.4 million charge includes certain severance and compensation-related charges, net of certain forfeitures of previously recognized equity-based compensation.

Interest and Other Expense, Net

Total interest and other expense, net, consists principally of interest expense incurred on our 2017 Senior Convertible Notes, and other income (expense), offset by income earned on marketable securities. Total interest expense, net, was relatively consistent during the three and nine months ended September 30, 2015 compared to the same periods in 2014. Other income (expense), which includes foreign currency exchange and derivative instrument gains (losses), was $0.4 million and $0.5 million, net of foreign currency hedges during the three and nine months ended September 30, 2015, respectively, and $(2.5) million and $(2.3) million during the three and nine months ended September 30, 2014, respectively. Our currency exposures vary, but are primarily concentrated in the pound sterling, the euro, the Australian dollar, the Singapore dollar, and the yen.

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Income Tax Expense (Benefit)

	September 30,	
(in thousands, except %)	2015	2014
Three Months Ended		
Income tax expense	$8,803	$9,088
Effective income tax rate	41 %	128 %
Nine Months Ended		
Income tax expense (benefit)	35,332	(4,065)
Effective income tax rate	39 %	14 %

The provision for income tax expense (benefit) as a percentage of pre-tax income from continuing operations was 41% for the three months ended September 30, 2015 compared with 128% for the three months ended September 30, 2014. The rate was lower in the third quarter of 2015 than in the third quarter of 2014 due primarily to discrete tax benefits associated with U.S. federal return to provision adjustments and changes in valuation allowance during the third quarter of 2015.

The provision for income tax expense (benefit) as a percentage of pre-tax income from continuing operations was 39% for the nine months ended September 30, 2015 compared with 14% for the nine months ended September 30, 2014. The rate was higher in 2015 than in 2014 due primarily to higher domestic earnings offset by lower losses without benefit and discrete benefits associated with executive compensation, U.S. return to provision adjustments and changes in valuation allowances. The 2015 effective tax rate of 39% was higher than the statutory federal income tax rate of 35% due primarily to losses in jurisdictions where we receive no tax benefit.

Liquidity, Cash Flows and Capital Resources

Liquidity and Capital Resources

Our principal sources of liquidity are our existing cash, cash equivalents and marketable securities, cash generated from operations and proceeds from our convertible debt financing issued in June 2011. We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, working capital requirements and capital deployment decisions. We have historically invested our cash primarily in the U.S. treasuries and government agencies, corporate debt, and money market funds. Certain of these investments are subject to general credit, liquidity and other market risks. The general condition of the financial markets and an economy may increase those risks and may affect the value and liquidity of our current investments and restrict our ability to access the capital markets.

Our future capital requirements will depend on many factors including our rate of revenue growth, the timing and extent of spending to support development efforts, the expansion of sales, marketing and administrative activities, the timing of introductions of new products and enhancements to existing products, successful vertical integration of our manufacturing process, the continuing market acceptance of our products, the expenditures associated with possible future acquisitions or other business combination transactions, the outcome of current and future litigation, the evolution of our globalization initiative, and continuous international expansions of our business. We believe our current cash and cash equivalents, investments and cash provided by operations will satisfy our working capital requirements, debt obligations and capital expenditures for the foreseeable future. However, should we need to access the debt or equity market, we believe we could do so at reasonable borrowing and capital costs.

A substantial portion of our operations are located in the United States, and the majority of our sales and cash generation since inception have been made in the United States. Accordingly, we do not have material cash flow exposure to foreign currency rate fluctuations. However, as our business in markets outside of the United States continues to increase, we will be exposed to foreign currency exchange risk related to our foreign operations. Fluctuations in the rate of exchange between the United State dollar and foreign currencies, primarily in the pound sterling, the euro, the Australian dollar, the Singapore dollar, and the yen, could adversely affect our financial results, including our revenues, revenue growth rates, gross margins, income and losses as well as assets and liabilities. We enter into forward currency contracts to partially offset the impact from fluctuations of the foreign currency rates on our short-term intercompany receivables and payables between our domestic and international operations. At September 30, 2015, the cash balance held by our foreign subsidiaries was approximately $26.2 million and it is our intention to indefinitely reinvest all of current foreign earnings in order to partially support foreign working capital and to expand our existing operations outside the United States. In the event that we needed to utilize that cash in the United States we do not expect it would drive significant incremental tax obligations. As of September 30, 2015, $18.3 million of accounts receivable was held in currency other than the United States dollar. We have operations in markets in which there is governmental instability which could impact funds that flow into the medical reimbursement system. In addition, loss of financial stability within these markets could lead to delays in reimbursement or inability to remit payment due to currency controls. Specifically, we have operations in Puerto Rico, Greece, Argentina and Venezuela. We do not have any material financial exposure to one customer or one country that would significantly hinder our liquidity.

In connection with the Medtronic litigation, a jury from the U.S. District Court, Southern District of California delivered an unfavorable verdict to us and awarded monetary damages of approximately $101.2 million to Medtronic. In May 2012, in accordance with an escrow arrangement, we transferred $113.3 million of cash into a restricted escrow account to secure the amount of the judgment, plus prejudgment interest, during pendency of our appeal of the judgment. During 2013, we and Medtronic entered into a settlement agreement fully resolving the second phase of the case and we made a one-time payment to Medtronic of $7.5 million. In March 2015, the Court of Appeals ruled in favor of us, overturning the previous ruling that Medtronic was entitled to lost profits. We have thus reduced our royalty accrual and long-term litigation liability by $56.4 million during the nine months ended September 30, 2015. Accordingly, our accrual for the Medtronic litigation as of September 30, 2015 was $87.6 million in long-term liabilities. As a result of the March 2, 2015 Court of Appeals decision upholding the jury's findings of liability as to all patents, but overturning the damage award against us as improper we were no longer required to escrow funds related to Phase I of the ongoing litigation. During the three months ended September 30, 2015, the funds in escrow, approximately $114.1 million, were returned to our unrestricted investment accounts from our long-term restricted cash and investments. In the event we have a significant cash outflow related to the litigation, the cash will be funded through our unrestricted cash and investments. See Note 11 to the Unaudited Consolidated Financial Statements for further discussion.

On April 3, 2014, an unfavorable jury verdict was delivered against us relating to our use of the trade name "NeuroVision". At that time, we established a liability of $30.0 million for this matter. During the nine months ended September 30, 2015 we agreed to settle all outstanding matters related to this matter for $27.2 million. We previously escrowed funds totaling $32.5 million to secure the amount of judgment, and cover potential attorney's fees and costs. Those funds were released from escrow to fund the settlement during the three months ended September 30, 2015.

In 2013, we received a federal administrative subpoena from the Office of the Inspector General of the U.S. Department of Health and Human Services, or the OIG, in connection with an investigation into possible false or otherwise improper claims submitted to Medicare and Medicaid. The subpoena sought discovery of documents for the period January 2007 through April 2013. In April 2015, we announced that we had reached an agreement in principle with the U.S. Department of Justice ("DOJ") to settle this matter, and in July 2015, we entered into a definitive settlement agreement. Under the terms of the agreement, we agreed to pay $13.5 million plus fees and accrued interest of approximately $0.3 million to resolve this matter. The settlement was not an admission of liability or wrongdoing, and we were not required to enter into a corporate integrity agreement with the OIG as part of the settlement. In accordance with the authoritative guidance on the evaluation of loss contingencies, we recorded a $13.8 million liability related to this matter in the first quarter 2015, and funded $12.9 million of the settlement during the three months ended September 30, 2015, with $0.9 million payable outstanding in the settlement included in current liabilities as of September 30, 2015.

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Cash, cash equivalents and marketable securities was $451.2 million and $405.8 million at September 30, 2015 and December 31, 2014, respectively. We believe that our existing cash, cash equivalents and short-term and long-term marketable securities will be sufficient to meet our anticipated cash needs for the next 12 months. The change in cash during the nine months ended September 30, 2015 was mainly driven by our funding litigation settlements, including the trademark infringement settlement of $27.2 million and $12.9 million of the OIG settlement, cash tax payments on behalf of shareowners with net share settlement of $52.5 million, cash paid for purchased intangibles of $28.6 million that includes $27.4 million which was accrued for in the fourth quarter of 2014, and ordinary seasonal payments such as income tax obligations and annual bonuses. At September 30, 2015, we have cash and investments totaling $5.6 million in restricted accounts which are not available to us to meet any ongoing capital requirements if and when needed. Future litigation or requirements to escrow funds could materially impact our liquidity and our ability to invest in and run our business on an ongoing basis.

Cash Flows from Operating Activities

Cash provided by operating activities was $48.0 million for the nine months ended September 30, 2015, compared to $96.5 million for the same period in 2014. The $48.5 million decrease in cash provided by operating activities was primarily due to increases in cash tax obligations and the settling of litigation liabilities.

Cash Flows from Investing Activities

Cash used in investing activities was $19.3 million for the nine months ended September 30, 2015, compared to $81.6 million used for the same period in 2014. The $62.3 million decrease in cash used in investing activities was primarily due to the cash proceeds received in the sale of restricted cash and investments, partially offset by the payment for the purchase of intangible assets previously accrued for in the fourth quarter of 2014 and an increase in purchases of property and equipment primarily related to instruments in connection with new product launches.

Cash Flows from Financing Activities

Cash used in financing activities was $29.0 million for the nine months ended September 30, 2015, compared to $13.5 million of cash provided for the same period in 2014. The $42.5 million increase in cash used in financing activities was primarily due to net share settlements which result in cash tax payments we make on behalf of shareowners and a decrease in the cash receipt from the issuance of common stock upon the exercising of stock options. Net share settlement is generally used in lieu of cash payments by shareowners for minimum tax withholding or exercise costs for equity awards. The net share settlement is accounted for as a treasury share repurchase transaction, with the cost of any deemed repurchased shares included in treasury stock and reported as a reduction in total equity at the time of settlement. Additionally, net share settlement for tax withholding requires us to fund a significant amount of cash for certain tax payment obligations from time-to-time with respect to the shareowner tax obligations for vested equity awards. We anticipate using cash generated from operating activities to fund such payments.

Senior Convertible Notes

In June 2011, we issued $402.5 million principal amount of Senior Convertible Notes, which we refer to as the 2017 Notes, with a stated interest rate of 2.75% and a maturity date of July 1, 2017. The net proceeds from the offering, after deducting initial purchasers' discounts and costs directly related to the offering, were approximately $359.2 million. The 2017 Notes may be settled in cash, stock, or a combination thereof, solely at our discretion. It is our current intent and policy to settle all conversions through combination settlement, which involves repayment of an amount of cash equal to the principal amount and any excess of the conversion value over the principal amount in shares of common stock. The initial conversion rate of the 2017 Notes is 23.7344 shares per $1,000 principal amount, or equivalent to conversion price of approximately $42.13 per share, which is subject to adjustment. Beginning January 1, 2017 and until the close of business on the second scheduled trading day immediately preceding July 1, 2017, holders may convert their 2017 Notes at any time. Prior to January 1, 2017, holders may convert their 2017 Notes only under the conditions as described in Note 6 to the Unaudited Consolidated Financial Statements, which includes our common stock trading at 130% of the conversion price for 20 out of 30 consecutive trading days. It is our current intent and policy to settle all conversions through combination settlement, which involves satisfying the principal amount outstanding with cash and any note conversion value over the principal amount in shares of our common stock. The impact of the convertible feature will be dilutive to our earnings per share when our stock price average for the period is greater than the conversion price. Interest on the 2017 Notes began accruing upon issuance and is payable semi-annually on January 1st and July 1st each year.

In connection with the offering of the 2017 Notes, we entered into convertible note hedge transactions, which we refer to as the 2017 Hedge, with the initial purchasers and/or their affiliates, which we refer to as the Counterparties, entitling us to purchase up to 9,553,096 shares of our common stock at an initial stock price of $42.13 per share, each of which is subject to adjustment. The cost of the 2017 Hedge was $80.1 million. The 2017 Hedge expires on July 1, 2017. The 2017 Hedge is expected to reduce the potential equity dilution upon conversion of the 2017 Notes if the daily volume-weighted average price per share of our common stock exceeds the strike price of the 2017 Hedge.

In addition, we sold warrants, which we refer to as the 2017 Warrants, to the Counterparties to acquire up to 477,654 shares of our Series A Participating Preferred Stock, at an initial strike price of $988.51 per share, subject to adjustment. Each share of Series A Participating Preferred Stock is initially convertible into 20 shares of our common stock. The 2017 Warrants expire on various dates from September 2017 through January 2018 and may be settled in cash or net shares. It is our current intent and policy to settle all conversions in shares of our common stock, should the conversion occur. We received $47.9 million in cash proceeds from the sale of the 2017 Warrants. The 2017 Warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock during a given measurement period (the quarter or year-to-date period) exceeds the strike price of the 2017 Warrants.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our Unaudited Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our estimates including those related to bad debts, inventories, valuation of goodwill, intangibles, other long-term assets, stock-based compensation, income taxes, and legal proceedings. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities not readily apparent from other sources. Actual results may differ from these estimates. Our critical accounting policies and estimates are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 and there have been no material changes during the nine months ended September 30, 2015.

Off-Balance Sheet Arrangements

As of September 30, 2015 we did not have any off-balance sheet arrangements.

Contractual Obligations and Commitments

As of September 30, 2015, there were no material changes, outside of the ordinary course of business, in our outstanding contractual obligations from those disclosed within “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2015, there has been no material change in our assessment of our sensitivity to market risk since our presentation set forth in Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time lines specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in SEC Rules 13a - 15(e) and 15d - 15(e)) as of September 30, 2015. Based on such evaluation, our management has concluded that as of September 30, 2015, the Company's disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of any potential changes in our internal control over financial reporting during the fiscal quarter covered by this Quarterly Report.

There has been no change to our internal control over financial reporting during our most recent fiscal quarter that our certifying officers concluded materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a description of our material pending legal proceedings, refer to Note 11 "Contingencies" of the Notes to Unaudited Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report, which is incorporated herein by reference.

Item 1A. Risk Factors

The risk factors set forth below contain material changes to the risk factors previously disclosed and included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. An investment in our common stock involves a high degree of risk. You should consider carefully the risks and uncertainties described under Item 1A of Part I of our Annual Report on Form 10-K, as updated in this Item 1A (collectively the "Risk Factors") together with all other information contained or incorporated by reference in this report before you decide to invest in our common stock. If any of the Risk Factors were to actually occur, our business, financial condition, results of operations and our future growth prospects could be materially and adversely affected. Under the circumstances, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to Our Intellectual Property and Litigation

We are currently involved in patent litigation involving Medtronic, and, if we do not prevail in the litigation, we could be liable for substantial damages and might be prevented from making, using, selling, offering to sell, importing or exporting certain of our products.

On August 18, 2008, Medtronic filed suit against us in the U.S. District Court for the Southern District of California, alleging that certain of our products infringe, or contribute to the infringement of, U.S. patents owned by Medtronic. Trial in the first phase of the case began in August 2011, and in September 2011, a jury delivered an unfavorable verdict against us with respect to three Medtronic patents and a favorable verdict with respect to one of our patents.

The jury awarded monetary damages of approximately $0.7 million to us which includes back royalty payments. Additionally, the jury awarded monetary damages of approximately $101.2 million to Medtronic which includes lost profits and back royalties. On June 11, 2013, the District Court determined that the amount of ongoing royalties owed by us to Medtronic was 13.75% on certain of the Company's CoRoent XL implants and 8.25% on certain of the Company's MaXcess II and III retractors (the "June 2013 ruling").

On August 20, 2013, the parties filed their respective notices of appeal to the U.S. Court of Appeals for the Federal Circuit. On March 2, 2015, the Court of Appeals issued a decision upholding the jury's findings of liability as to all patents, but overturning the damage award against us as improper ("March 2nd Court of Appeals Decision"). Significantly, the Court of Appeals held that the damages award was erroneous because Medtronic was not permitted to recover damages for lost profits or for the sale of ancillary or "convoyed" products. Medtronic's subsequent petition for rehearing was denied. The case has been remanded back to the District Court for further proceedings to determine a proper damage award, and trial is scheduled to begin in April 2016.

We entered into an escrow arrangement in 2012 and transferred $113.3 million of cash into a restricted escrow account to secure the amount of judgment, plus prejudgment interest, during pendency of appeal. As a result of the June 2013 ruling relating to ongoing royalties, we would have been required to escrow funds to secure accrued royalties, but pursuant to an agreement between the parties, we did not escrow funds relating to ongoing royalties. As a result of the March 2nd Court of Appeals Decision, the parties agreed to release the escrow funds back to us. Thus, during the three months ended September 30, 2015, we transferred the funds in escrow related to this matter, approximately $114.1 million, into our unrestricted investment accounts. See Note 11 to the Unaudited Consolidated Financial Statements for further discussion.

In August 2012, Medtronic filed additional patent claims against us alleging that various Company spinal implants (including our CoRoent XL family of spinal implants) and our Osteocel Plus bone graft product, along with the XLIF procedure, infringe Medtronic patents not asserted in prior phases of the case. We deny infringing any valid claims of these additional patents and on March 7, 2013, we filed counterclaims against Medtronic asserting that Medtronic's MAST Quadrant retractor system, the NIM-Eclipse Spinal System, the Clydesdale Spinal System, the Capstone-L products, and the Direct Lateral Interbody Fusion procedure infringe eight Company patents. The District Court has stayed litigation of a number of Medtronic and Company patents currently subject to reexamination or review proceedings conducted by the Patent Office. No trial date has been set in this third phase of the litigation.

If we do not prevail in the Medtronic litigation we could be required to stop selling certain of our products, pay substantial monetary amounts as damages, and/or enter into expensive royalty or licensing arrangements. Such adverse results may limit our ability to generate profits and cash flow, and, as a consequence, to invest in and grow our business, including investments into new and innovative technologies.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number	Description
3.1	Restated Certificate of Incorporation (incorporated by reference to our Quarterly Report on Form 10-Q filed with the SEC on August 13, 2004)
3.2	Certificate of Amendment to the Restated Certificate of Incorporation (incorporated by reference to our Current Report on Form 8-K filed with the SEC on September 28, 2011)
3.3	Restated Bylaws (incorporated by reference to our Current Report on Form 8-K filed with the SEC on January 6, 2012)
3.4	Amendment No. 1 to the Restated Bylaws (incorporated by reference to our Current Report on Form 8-K filed with the SEC on May 19, 2014)
10.1#	NuVasive, Inc. Deferred Compensation Plan (incorporated by reference to our Current Report on Form 8-K filed with the SEC on August 6, 2015)
10.2#	NuVasive, Inc. Amended and Restated Executive Severance Plan (incorporated by reference to our Current Report on Form 8-K filed with the SEC on August 6, 2015)
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101 INS	XBRL Instance Document
101 SCH	XBRL Taxonomy Extension Schema Document
101 CAL	XBRL Taxonomy Calculation Linkbase Document
101 LAB	XBRL Taxonomy Label Linkbase Document

101 PRE	XBRL Taxonomy Presentation Linkbase Document
101 DEF	XBRL Taxonomy Definition Linkbase Document

# Indicates management contract or compensatory plan.

* These certifications are being furnished solely to accompany this annual report pursuant to 18 U.S.C. Section 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 NuVasive, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

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SIGNATURES

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

		NUVASIVE, INC.
Date:	October 27, 2015	By: /s/ Gregory T. Lucier Gregory T. Lucier Chairman and Chief Executive Officer (Principal Executive Officer)
Date:	October 27, 2015	By: /s/ Quentin S. Blackford Quentin S. Blackford Executive Vice President and Chief Financial Officer (Principal Financial Officer)

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