

Tornier N.V.  
Form 10-Q  
November 14, 2011  
[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended October 2, 2011**

**or**

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

**For the transition period from to**

**Commission file number: 1-35065**

## TORNIER N.V.

(Exact name of registrant as specified in its charter)

**The Netherlands**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**98-0509600**  
(IRS Employer  
Identification Number)

**Fred Roeskestraat 123**  
**1076 EE Amsterdam, The Netherlands**  
(Address of Principal Executive Offices)

**None**  
(Zip Code)

**(+ 31) 20 675 4002**

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒  
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

As of November 10, 2011, there were 39,263,154 ordinary shares outstanding.



Table of Contents

**TORNIER N.V.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTERLY PERIOD ENDED OCTOBER 2, 2011**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements</u>	4
<u>Consolidated Balance Sheets as of October 2, 2011 and January 2, 2011</u>	4
<u>Consolidated Statements of Operations for the Three and Nine Months ended October 2, 2011 and October 3, 2010</u>	5
<u>Consolidated Statements of Cash Flows for the Nine Months ended October 2, 2011 and October 3, 2010</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	24
<u>Item 4. Controls and Procedures</u>	25
<b><u>PART II OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	26
<u>Item 1A. Risk Factors</u>	26
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
<u>Item 3. Defaults Upon Senior Securities</u>	27
<u>Item 4. [Removed and Reserved]</u>	27
<u>Item 5. Other Information</u>	27
<u>Item 6. Exhibits</u>	27
<u>SIGNATURES</u>	28
<u>EXHIBIT INDEX</u>	29

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On January 28, 2011, Tornier B.V., a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) changed its legal form by converting to Tornier N.V., a public company with limited liability (*naamloze vennootschap*). This is referred to as the conversion in this report.

References to Tornier, Company, we, our or us in this report refer to Tornier B.V. and its subsidiaries prior to the conversion and to Tornier and its subsidiaries upon and after the conversion, unless the context otherwise requires.

This report contains references to among others, our trademarks Aequalis®, Ascend , Piton®, Stabilis , Wave®, and Tornier . All other trademarks or trade names referred to in this report are the property of their respective owners.



Table of Contents

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical fact included in this report that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements including, in particular, the statements about our plans, objectives, strategies and prospects regarding, among other things, our financial condition, results of operations and business. We have identified some of these forward-looking statements with words like believe, may, will, should, could, expect, intend, plan, predict, anticipate, estimate or continue other words having similar meaning and the use of future dates. These forward-looking statements may be contained throughout this report, including but not limited to statements under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations. These forward-looking statements are based on current expectations about future events affecting us and are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control and could cause our actual results to differ materially from those matters expressed or implied by our forward-looking statements. Forward-looking statements (including oral representations) are only predictions or statements of current plans and can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including, among other things, risks associated with:

- a history of operating losses and negative cash flow;
- not successfully developing and marketing new products and technologies and implementing our business strategy;
- not successfully competing against our existing or potential competitors;
- continuing weakness in the global economy, which may be exacerbated by austerity measures anticipated to be taken by several countries and which could reduce the availability or affordability of private insurance or may affect patient decision to undergo elective procedures, and could otherwise adversely affect our business and results of operations;
- deriving a significant portion of our revenues from operations in certain geographic markets that are subject to political, economic and social instability and risks and uncertainties involved in launching our products in certain new geographic markets;
- our private label manufacturers failing to provide us with sufficient supply of their products, or failing to meet appropriate quality requirements;
- our plans to bring the manufacturing of certain of our products in-house and possible disruptions we may experience in connection with such transition;

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- the loss of one of our key suppliers, which may result in our inability to meet customer orders for our products in a timely manner or within our budget;
- our patents and other intellectual property rights not adequately protecting our products, which may result in our loss of market share to our competitors;
- the incurrence of significant expenditures of resources to maintain relatively high levels of inventory, which could reduce our cash flows and increase the risk of inventory obsolescence, which could harm our operating results;
- turmoil in the worldwide credit and financial markets, which may be exacerbated by the European sovereign debt crisis and which may negatively affect our business, financial condition or results of operations;
- the inability to raise capital when needed, which could force us to delay, reduce, eliminate or abandon our commercialization efforts or product development programs;
- restrictive covenants in our outstanding debt agreements that may limit our operating flexibility;
- consolidation in the healthcare industry that could lead to demands for price concessions or to the exclusion of some suppliers from certain of our markets, which could have an adverse effect on our business, financial condition or results of operations;
- regulatory clearances or approvals and the extensive regulatory requirements to which we are subject;
- the compliance of our products with the laws and regulations of the foreign countries in which they are marketed, which compliance may be costly and time-consuming;
- the use, misuse or off-label use of our products that may harm our image in the marketplace or result in injuries that lead to product liability suits, which could be costly to our business or result in U.S. Food and Drug Administration (FDA) sanctions; and

Table of Contents

- healthcare reform legislation and its future implementation, possible additional legislation, regulation and other governmental pressure in the United States and globally, which may affect utilization, pricing, reimbursement, taxation and rebate policies of governmental agencies and private payors, which could have an adverse effect on our business, financial condition or results of operations.

For more information regarding these and other uncertainties and factors that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements or otherwise could materially adversely affect our business, financial condition or operating results, see our annual report on Form 10-K for the fiscal year ended January 2, 2011 under the heading **Part I Item 1A. Risk Factors** on pages 24 through 53 of such report and **Part II Item 1A Risk Factors** of this report. The risks and uncertainties described above and under the heading **Part I Item 1A Risk Factors** in our annual report on Form 10-K for the fiscal year ended January 2, 2011 and **Part II Item 1A Risk Factors** of this report are not exclusive and further information concerning us and our business, including factors that potentially could materially affect our financial results or condition, may emerge from time to time. We assume no obligation to update, amend or clarify forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. We advise you, however, to consult any further disclosures we make on related subjects in our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K we file with or furnish to the Securities and Exchange Commission.



Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****TORNIER N.V. AND SUBSIDIARIES****Consolidated Balance Sheets****(In Thousands, Except Share and Per Share Amounts)**

	<b>October 2, 2011 (unaudited)</b>	<b>January 2, 2011</b>
<b>Assets</b>		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 55,848	\$ 24,838
Accounts receivable (net of allowance of \$2,349 and \$2,519, respectively)	42,703	42,758
Inventories	85,726	77,525
Income taxes receivable		2,835
Deferred income taxes	1,245	2,587
Prepaid taxes	12,589	11,179
Prepaid expenses	2,299	7,444
Other current assets	3,650	4,048
Total current assets	204,060	173,214
Instruments, net	48,802	42,378
Property, plant and equipment, net	33,454	33,680
Goodwill	133,724	131,830
Intangible assets, net	102,024	109,024
Deferred income taxes	443	440
Other assets	1,312	612
Total assets	\$ 523,819	\$ 491,178
<b>Liabilities and shareholders' equity</b>		
<i>Current liabilities:</i>		
Short-term borrowings and current portion of long-term debt	\$ 20,956	\$ 28,392
Accounts payable	12,010	12,890
Accrued liabilities	30,637	34,620
Income taxes payable	763	327
Deferred income taxes	7	20
Total current liabilities	64,373	76,249
Notes payable		84,261
Other long-term debt	24,356	25,467
Deferred income taxes	19,937	28,706
Contingent liabilities		1,860
Other non-current liabilities	3,981	4,396
Total liabilities	112,647	220,939
<i>Shareholders' equity:</i>		
	1,559	1,156

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Ordinary shares, 0.03 par value; authorized 175,000,000 and 100,000,000 at October 2, 2011 and January 2, 2011, respectively; issued and outstanding 39,244,166 and 29,568,731 at October 2, 2011 and January 2, 2011, respectively

Additional paid-in capital	606,590	437,307
Accumulated deficit	(212,007)	(183,532)
Accumulated other comprehensive income	15,030	15,308
Total shareholders' equity	411,172	270,239
Total liabilities and shareholders' equity	\$ 523,819	\$ 491,178

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

Table of Contents**TORNIER N.V. AND SUBSIDIARIES****Consolidated Statements of Operations****(In Thousands, Except Per Share Amounts)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>October 2,</b>	<b>October 3,</b>	<b>October 2,</b>	<b>October 3,</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>(unaudited)</b>		<b>(unaudited)</b>	
Revenue	\$ 57,556	\$ 49,707	\$ 192,149	\$ 166,113
Cost of goods sold	16,650	13,553	54,708	45,554
Gross profit	40,906	36,154	137,441	120,559
Operating expenses:				
Sales and marketing	31,764	29,474	101,335	93,665
General and administrative	6,173	5,449	18,560	16,643
Research and development	4,309	3,898	14,608	12,714
Amortization of intangible assets	2,741	2,842	8,448	8,720
Special charges	56	54	188	306
Total operating expenses	45,043	41,717	143,139	132,048
Operating loss	(4,137)	(5,563)	(5,698)	(11,489)
Other income (expense):				
Interest expense	(379)	(5,282)	(3,346)	(16,047)
Foreign currency transaction gain (loss)	(228)	(3,728)	(81)	(9,467)
Loss on extinguishment of debt			(29,475)	
Other non-operating income (expense)	993	283	1,009	344
Loss before income taxes	(3,751)	(14,290)	(37,591)	(36,659)
Income tax (expense) benefit	2,114	1,531	9,116	5,246
Consolidated net loss	(1,637)	(12,759)	(28,475)	(31,413)
Net loss attributable to non-controlling interest				(695)
Net loss attributable to Tornier	(1,637)	(12,759)	(28,475)	(30,718)
Accretion of non-controlling interest				(679)
Net loss attributable to ordinary shareholders	\$ (1,637)	\$ (12,759)	\$ (28,475)	\$ (31,397)
Net loss per share:				
Basic and diluted	\$ (0.04)	\$ (0.43)	\$ (0.75)	\$ (1.15)
Weighted average shares outstanding:				
Basic and diluted	39,150	29,569	37,882	27,192

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

Table of Contents**TORNIER N.V. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(In Thousands)**

	<b>Nine months ended</b>	
	<b>October 2,</b>	<b>October 3,</b>
	<b>2011</b>	<b>2010</b>
	<b>(unaudited)</b>	
Cash flows from operating activities:		
Consolidated net loss	\$ (28,475)	\$ (31,413)
Adjustments to reconcile consolidated net loss to cash provided by operating activities:		
Depreciation and amortization	21,038	19,842
Non-cash foreign currency loss	387	8,787
Deferred income taxes	(8,993)	(5,570)
Share-based compensation	4,741	4,187
Non-cash interest expense and discount amortization	2,040	14,599
Inventory obsolescence	3,814	4,031
Loss on extinguishment of debt	29,475	
Other non-cash items affecting earnings	(347)	745
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(534)	660
Inventories	(11,015)	(17,235)
Accounts payable and accruals	(3,449)	4,590
Other current assets and liabilities	3,556	(3,855)
Other non-current assets and liabilities	(1,277)	127
Net cash provided by (used in) operating activities	10,961	(505)
Cash flows from investing activities:		
Acquisition-related cash payments	(2,053)	(1,992)
Additions of instruments	(15,042)	(10,508)
Purchases of property, plant and equipment	(3,772)	(5,540)
Net cash used in investing activities	(20,867)	(18,040)
Cash flows from financing activities:		
Change in short-term debt	(8,185)	7,129
Repayments of long-term debt	(6,458)	(5,003)
Proceeds from issuance of long-term debt	4,751	5,351
Deferred financing costs	(2,731)	(1,676)
Repayment of notes payable	(116,108)	
Issuance of ordinary shares	171,215	806
Net cash provided by financing activities	42,484	6,607
Effect of exchange rate changes on cash and cash equivalents	(1,568)	(529)
Increase (decrease) in cash and cash equivalents	31,010	(12,467)
Cash and cash equivalents:		
Beginning of period	24,838	37,969
End of period	\$ 55,848	\$ 25,502
Non-cash investing and finance activities:		
Fixed assets acquired pursuant to capital lease	\$ 646	\$

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

Table of Contents

**TORNIER N.V. AND SUBSIDIARIES**

**Notes to the Consolidated Financial Statements**

**(unaudited)**

**1. Business Description**

Tornier N.V. (Tornier or the Company) is a global medical device company focused on surgeons that treat musculoskeletal injuries and disorders of the shoulder, elbow, wrist, hand, ankle and foot. The Company refers to these surgeons as extremity specialists. The Company sells to this extremity specialist customer base a broad line of joint replacement, trauma, sports medicine and biologic products to treat extremity joints. The Company's motto of specialists serving specialists encompasses this focus. In certain international markets, Tornier also offers joint replacement products for the hip and knee. The Company currently sells approximately 90 product lines in approximately 35 countries.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The unaudited condensed consolidated financial statements include the accounts of Tornier N.V. and all of its wholly and majority owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and the instructions to quarterly report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to these rules and regulations. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended January 2, 2011, as filed with the U.S. Securities and Exchange Commission (SEC).

In the opinion of the Company's management, the unaudited interim financial statements have been prepared on the same basis as the audited financial statements and include all adjustments, consisting of normal recurring accruals, necessary for the fair presentation of the Company's interim results. The results of operations for any interim period are not indicative of results for the full fiscal year.

The condensed consolidated financial statements are prepared in conformity with United States generally accepted accounting principles (GAAP) and include amounts that are based on management's best estimates and judgments. Actual results could differ from those estimates. All amounts are presented in U.S. Dollars ( \$ ), except where expressly stated as being in other currencies, e.g., Euros ( € ).

Certain amounts reported in previous periods have been reclassified to conform to the current period presentation.

On January 28, 2011, the Company executed a 3-to-1 reverse stock split of the Company's ordinary shares. All share and per share amounts for all periods presented in these condensed consolidated financial statements reflect this split.

On January 28, 2011, the Company made a change to its legal form by converting from Tornier B.V., a private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid*) to Tornier N.V., a public company with limited liability (*naamloze vennootschap*).

The Company's fiscal quarters are generally determined on a 13-week basis and always end on a Sunday. As a result, the Company's fiscal year is generally 364 days. Fiscal year-end periods end on the Sunday nearest to December 31. Every few years, it is necessary to add an extra week to a quarter to make it a 14-week period in order to have the year end fall on the Sunday nearest to December 31. For example, the first three quarters of 2010 include an extra week of operations compared to the first three quarters of 2011.

#### **Recent Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board (FASB) issued ASU 2010-6, *Fair Value Measurements and Disclosures (ASC Topic 820): Improving Disclosures about Fair Value Measurements*, which requires reporting entities to make new disclosures about recurring or nonrecurring fair value measurements including (i) significant transfers into and out of Level 1 and Level 2 fair value measurements and (ii) information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. ASU 2010-6 was effective for interim and annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which were effective for interim and annual periods beginning after December 15, 2010. The Company adopted the additional disclosures required for Level 1 and Level 2 fair value measurements in the first quarter of 2010 and Level 3 disclosures during the first quarter of 2011.

## Table of Contents

In May 2011, the FASB issued ASU 2011-4, *Fair Value Measurement (ASC Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, which was intended by the FASB and the International Accounting Standards Board (IASB) to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards (IFRSs). Additional disclosures required by this amendment include information about transfers between Level 1 and Level 2 instruments, information regarding the sensitivity of Level 3 instruments, and categorization by level of items that are not measured at fair value in the statement of financial position (but for which disclosure of fair value is still required). The guidance is effective prospectively for fiscal years beginning after December 15, 2011 and interim periods within those years. The adoption of this guidance is not expected to have a material impact on the Company's financial position or operating results.

In September 2011, the FASB issued ASU 2011-08, *Intangibles, Goodwill and Other (ASC Topic 350), Testing Goodwill for Impairment* (the revised standard). The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. An entity can choose to early adopt if its annual test date is before the issuance of the final standard, provided that the entity has not yet performed its 2011 annual impairment test or issued its financial statements. Entities considering early adoption should begin assessing relevant factors for the qualitative assessment. An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The Company is currently evaluating the early adoption option. The Company does not expect the adoption or early adoption of this update to have any impact on the Company's financial position or operating results.

### **3. Fair Value of Financial Instruments**

The Company applies ASC Topic 820, which establishes a framework for measuring fair value and clarifies the definition of fair value within that framework. ASC Topic 820 defines fair value as an exit price, which is the price that would be received for an asset or paid to transfer a liability in the Company's principal or most advantageous market in an orderly transaction between market participants on the measurement date. The fair value hierarchy established in ASC Topic 820 generally requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect the assumptions that market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the entity's own assumptions based on market data and the entity's judgments about the assumptions that that market participants would use in pricing the asset or liability, and are to be developed based on the best information available in the circumstances.

When an active market for certain financial instruments does not exist, it may be appropriate to use unobservable inputs to determine fair value. The carrying value of the Company's cash and cash equivalents, accounts receivable, and accounts payable approximates the fair value of these financial instruments at October 2, 2011 and January 2, 2011. Assets and liabilities measured at fair value are done so on a recurring basis. U.S. GAAP requires fair value measurements to be classified and disclosed in one of the following three categories:

*Level 1* Assets and liabilities with unadjusted, quoted prices listed on active market exchanges.

*Level 2* Assets and liabilities determined using prices for recently traded assets and liabilities with similar underlying terms, as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.



*Level 3* Assets and liabilities that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the asset or liability. The prices are determined using significant unobservable inputs or valuation techniques.

Cash and cash equivalents are classified as Level 1 fair value measurements. As of October 2, 2011, the Company had no material assets or liabilities with recurring Level 2 or Level 3 fair value measurements.

#### 4. Inventories

Inventory balances consist of the following (in thousands):

	October 2, 2011		January 2, 2011	
Raw materials	\$	6,694	\$	7,913
Work-in-process		8,370		5,356
Finished goods		70,662		64,256
Total	\$	85,726	\$	77,525

Table of Contents**5. Property, Plant and Equipment**

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

	October 2, 2011		January 2, 2011
Land	\$ 2,215	\$	2,195
Building and improvements	12,094		10,087
Machinery and equipment	21,297		20,420
Furniture, fixtures and office equipment	24,010		22,066
Software	4,300		4,134
Construction in progress	131		129
	64,047		59,031
Accumulated depreciation	(30,593)		(25,351)
Property, plant and equipment, net	\$ 33,454	\$	33,680

**6. Instruments**

Instruments included in long-term assets on the consolidated balance sheets consist of the following (in thousands):

	October 2, 2011		January 2, 2011
Instruments	\$ 70,402	\$	58,356
Instruments in process	17,971		15,007
Accumulated depreciation	(39,571)		(30,985)
Instruments, net	\$ 48,802	\$	42,378

**7. Goodwill and Other Intangible Assets**

The following table summarizes the changes in the carrying amount of goodwill (in thousands):

Balance at January 2, 2011	\$ 131,830
Contingent payment on acquisition	1,099
Foreign currency translation	795
Balance at October 2, 2011	\$ 133,724

The components of identifiable intangible assets are as follows (in thousands):

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	Gross value	Accumulated amortization	Net value
Balances at October 2, 2011			
Intangible assets subject to amortization:			
Developed technology	\$ 76,943	\$ (28,561)	\$ 48,382
Customer relationships	62,317	(21,493)	40,824
Licenses	4,058	(1,928)	2,130
Other	1,701	(1,031)	670
Intangible assets not subject to amortization:			
Trade name	10,018		10,018
Total	\$ 155,037	\$ (53,013)	\$ 102,024

Table of Contents

	Gross value	Accumulated amortization	Net value
<b>Balances at January 2, 2011</b>			
Intangible assets subject to amortization:			
Developed technology	\$ 76,561	\$ (24,164)	\$ 52,397
Customer relationships	61,838	(18,275)	43,563
Licenses	3,965	(1,492)	2,473
Other	1,645	(967)	678
Intangible assets not subject to amortization:			
Trade name	9,913		9,913
Total	\$ 153,922	\$ (44,898)	\$ 109,024

Estimated annual amortization expense for fiscal years ending 2011 through 2015 is as follows (in thousands):

	Amortization expense
2011	\$ 10,698
2012	10,443
2013	10,407
2014	10,364
2015	10,356

**8. Other Long-Term Debt**

A summary of debt is as follows (in thousands):

	October 2, 2011	January 2, 2011
Lines of credit	\$ 12,752	\$ 20,639
Mortgages	5,875	6,342
Other term debt	24,304	24,522
Shareholder debt	2,381	2,356
Total debt	45,312	53,859
Less current portion	(20,956)	(28,392)
Long-term debt	\$ 24,356	\$ 25,467

The Company's European subsidiaries have established unsecured lines of credit totaling \$24.8 million and \$21.9 million at October 2, 2011 and January 2, 2011, respectively. Borrowings under these lines were \$11.4 million and \$15.4 million at October 2, 2011 and January 2, 2011, respectively. Borrowings under these lines have variable interest rates based on the Euro Overnight Index Average plus 1.3% or a three-month Euro plus 0.5%-3.0%.

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The Company's U.S. subsidiary has established a \$10.0 million secured line of credit at October 2, 2011 and January 2, 2011. This line of credit expires in July 2012 and is callable by the bank at any time. Also, the line is secured by working capital and equipment. Borrowings under the line were \$1.3 million and \$5.2 million at October 2, 2011 and January 2, 2011, respectively. Borrowings under the line of credit bear interest at a 30-day LIBOR plus 2.25%, with a floor interest rate of 5%. This line contains customary affirmative and negative covenants and events of default. As of October 2, 2011, the Company's U.S. subsidiary was subject to a covenant to maintain no less than \$39.0 million of tangible net worth. Also as of October 2, 2011, the Company was subject to a covenant to maintain a maximum debt to tangible net worth ratio of 1.50. The covenants relate to the U.S. subsidiary's ratios only. The Company was in compliance with all covenants as of October 2, 2011.

The Company has a mortgage secured by the Company's U.S. subsidiary's office building in Stafford, Texas. This mortgage had an outstanding amount of \$1.3 million at October 2, 2011 and January 2, 2011. This mortgage bears a fixed annual interest rate of 6.7%.

The Company also has a mortgage secured by an office building in Grenoble, France. This mortgage had an outstanding balance of \$4.6 million and \$5.0 million at October 2, 2011 and January 2, 2011, respectively. This mortgage bears a fixed annual interest rate of 4.9%.

Table of Contents

The Company's U.S. subsidiary had long-term debt secured by its working capital and equipment that was repaid during the second quarter of 2011. This debt had an outstanding amount of \$0.3 million at January 2, 2011. This debt accrued interest based on a variable rate of LIBOR plus 2.25%.

The Company's international subsidiaries have other long-term secured and unsecured notes totaling \$24.3 million and \$24.2 million at October 2, 2011 and January 2, 2011, respectively, with initial maturities ranging from 3 to 10 years. A portion of these notes have fixed annual interest rates that range from 2.9% to 7.5%. The remaining notes carry a variable annual interest rate based on LIBOR, plus 1.2%, or a three-month Euro, plus 0.3% to 1.5%.

One of the Company's 51%-owned and consolidated subsidiaries borrowed \$2.4 million from a member of the Company's Board of Directors who is also a 49% owner of the consolidated subsidiary. This loan was used to partially fund the purchase of real estate in Grenoble, France, to be used as a manufacturing facility. Interest on the debt is variable based on three-month Euro plus 0.5%. The non-controlling interest in this subsidiary is deemed immaterial to the consolidated financial statements.

**9. Notes Payable and Warrants to Issue Ordinary Shares**

In April 2009, the Company issued notes payable in the amount of 37 million (approximately \$49.3 million) to a group of investors that included then existing shareholders, new investors and management of the Company. The notes carried a fixed annual interest rate of 8.0% with interest payments accrued in kind semi-annually. The notes were scheduled to mature in March 2014.

In connection with the note agreement, the Company also issued warrants to purchase an aggregate of 2.9 million ordinary shares at an exercise price of \$16.98 per share. The Company recorded the warrants as liabilities with an offsetting debt discount recorded as a reduction of the carrying value of the notes. The debt discount was being amortized as additional interest expense over the life of the notes.

In February 2008, the Company issued notes payable in the amount of 34.5 million (approximately \$52.4 million) to a group of investors that included then existing shareholders and management of the Company. The notes carried a fixed annual interest rate of 8.0% with interest payments accrued in-kind. The notes were scheduled to mature on February 28, 2013. Also, in connection with the 2008 note agreement, the Company issued warrants to purchase an aggregate of 3.1 million ordinary shares at an exercise price of \$16.98 per share. The Company had recorded the warrants as liabilities with an offsetting debt discount recorded as a reduction of the carrying value of the notes. The debt discount was being amortized as additional interest expense over the life of the notes.

In February 2011, the Company used approximately \$116.1 million ( 86.4 million) of the net proceeds from its initial public offering to repay all of the outstanding indebtedness under the notes payable, including accrued interest thereon. At the time of repayment, the Company recognized a loss on debt extinguishment of \$29.5 million and related deferred tax benefit of \$7.5 million to recognize the remaining balance of unamortized discount on the notes and to reverse the related deferred tax liability.

Notes payable balances were as follows:

	February 14, 2011 (Time of Repayment)		January 2, 2011	
Gross notes payable	\$	116,109	\$	114,357
Discount to notes payable		(29,352)		(30,096)
Net notes payable	\$	86,757	\$	84,261

In May 2010, the Company executed agreements with 100% of the warrant holders that acquired warrants under the February 2008 and April 2009 notes payable and warrant issuances to exchange their outstanding warrants for the Company's ordinary shares. Each warrant holder agreed to exchange their warrants under the February 2008 and April 2009 agreements for ordinary shares of the Company at an exchange ratio of 0.6133 and 0.6410, respectively. In order to settle the warrant liabilities related to the February 2008 and April 2009 warrant issuances, the Company issued 1,894,076 and 1,885,624 ordinary shares, respectively. The Company determined the fair value of its ordinary shares to be \$22.50 per share at the date of the exchange which resulted in the issuance of ordinary shares with a total value of \$85.0 million. This amount, net of \$21.7 million of tax was recognized as an increase to equity at the time of the exchange. The Company recognized a gain on the change in fair value of the warrant liability of \$0.2 million in non-operating expense, net during the year ended January 2, 2011 to adjust the carrying value of the warrant liability to the final settlement amount. The Company also recognized \$11.6 million of foreign currency transaction loss on the warrant liability for the year ended January 2, 2011. This transaction settled the warrant liability of \$85.2 million included in the consolidated balance sheet at December 27, 2009.

Table of Contents

Changes in the carrying value of warrants are as follows:

Warrant value at December 28, 2008	\$	29,277
Impact of adoption of ASC Topic 815 fair value adjustment		(1,159)
Issuance of 2009 warrants at fair value		29,070
Change in fair value during the year		28,027
Warrant value at December 27, 2009	\$	85,215
Change in fair value during the period		(147)
Warrant value at April 4, 2010	\$	85,068
Change in fair value during the period		(25)
Fair value of shares issued to settle liability and recognized in equity on May 27, 2010		85,043
Warrant value at July 4, 2010	\$	

**10. Share-Based Compensation**

Below is a summary of the allocation of share-based compensation recognized within the consolidated financial statements (in thousands):

	Three months ended		Nine months ended	
	October 2,	October 3,	October 2,	October 3,
	2011	2010	2011	2010
	(unaudited)		(unaudited)	
Cost of goods sold	\$ 199	\$ 46	\$ 586	\$ 369
Sales and marketing	608	490	1,587	1,263
General and administrative	884	685	2,197	2,223
Research and development	140	131	371	332
Total	\$ 1,831	\$ 1,352	\$ 4,741	\$ 4,187

During the nine months ended October 2, 2011, the Company granted options to purchase an aggregate of 0.7 million ordinary shares and 0.2 million restricted stock units at a weighted average fair value of \$11.90 and \$25.16 per share, respectively, to be recognized on a straight line basis over their service period of four years. The weighted average per share exercise price for options granted during the nine months ended October 2, 2011 is \$24.35. As of October 2, 2011, the Company had options to purchase an aggregate of approximately 4.2 million ordinary shares (of which options to purchase an aggregate of approximately 2.6 million ordinary shares were exercisable) and 0.2 million restricted stock units outstanding. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model using the following weighted-average assumptions:

	Nine months ended October 2, 2011
Risk-free interest rate	2.2%
Expected life in years	6.1
Expected volatility	48.6%
Expected dividend yield	0.0%



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The Company had \$19.1 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted to employees as of October 2, 2011. That cost is expected to be recognized over a weighted-average period of 2.8 years.

### 11. Income Taxes

The Company operates in multiple income tax jurisdictions both inside and outside the United States. Income tax authorities in these jurisdictions regularly perform audits of the Company's income tax filings. Accordingly, management must determine the appropriate allocation of income to each of these jurisdictions based on current interpretations of complex income tax regulations. Income tax audits associated with the allocation of this income and other complex issues, including inventory transfer pricing and cost sharing, product royalty and foreign branch arrangements, may require an extended period of time to resolve and may result in significant income tax adjustments if changes to the income allocation are required between jurisdictions with different income tax rates.

Table of Contents

During the first quarter of 2011, the Company recognized \$7.5 million of deferred tax benefit related to the \$29.5 million loss on extinguishment of debt previously discussed. This benefit was the result of reversing the remaining deferred tax liability related to the unamortized debt discount on the Company's notes payable at the time of repayment. The additional income tax benefit recorded during the period primarily related to the Company's French subsidiaries. Given the Company's history of operating losses, the Company does not generally recognize a provision for income taxes in the United States and certain of the Company's European sales offices.

The income tax benefit in the first nine months of 2010 primarily relates to tax benefit recorded related to the Company's French subsidiaries as well as deferred tax benefit on the amortization of the debt discount recognized on the Company's notes payable.

## **12. Capital Stock and Earnings Per Share**

The Company had 39.2 million and 29.6 million ordinary shares issued and outstanding as of October 2, 2011 and October 3, 2010, respectively.

The Company completed an initial public offering of its ordinary shares pursuant to a registration statement that was declared effective by the SEC on February 2, 2011. The Company sold 8,750,000 shares, at an initial price to the public of \$19.00 per share (before underwriters discounts and commissions) on February 8, 2011 and received net proceeds of approximately \$149.5 million, after underwriters' discounts and commissions of approximately \$10.8 million and offering related expenses of \$5.9 million. Subsequently, on March 7, 2011, the Company sold an additional 721,274 ordinary shares at an offering price of \$19.00 per share (before underwriters' discounts and commissions) due to the exercise of the underwriters' overallotment option, and received additional net proceeds of approximately \$12.8 million, after underwriters' discounts and commissions of approximately \$0.9 million. Aggregate gross proceeds from the offering, including the exercise of the over-allotment option, were \$179.9 million and net proceeds received after underwriters' discounts and commissions and offering related expenses were approximately \$162.3 million.

The Company had options to purchase ordinary shares and restricted stock units outstanding of an aggregate of 4.4 million and 3.5 million ordinary shares at October 2, 2011 and October 3, 2010, respectively. None of the options or restricted stock units were included in diluted earnings per share for the nine months ended October 2, 2011 and October 3, 2010, respectively, because the Company recorded a net loss in all periods and, therefore, including these instruments would be anti-dilutive.

## **13. Other Comprehensive Income (Loss)**

Other comprehensive income (loss) refers to revenues, expenses, gains, and losses that under U.S. GAAP are included in comprehensive income (loss) but are excluded from net earnings, as these amounts are recorded directly as an adjustment to shareholders' equity. Other comprehensive income (loss) is comprised mainly of foreign currency translation adjustments.

The reconciliation of net loss to comprehensive loss is as follows (in thousands):

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	Three months ended		Nine months ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(unaudited)		(unaudited)	
Net loss	\$ (1,637)	\$ (12,759)	\$ (28,475)	\$ (30,718)
Foreign currency translation adjustments	(16,751)	15,946	(278)	1,847
Total comprehensive income (loss)	\$ (18,388)	\$ 3,187	\$ (28,753)	\$ (28,871)

## 14. Non-Controlling Interests

The Company currently markets the Piton Knotless Anchor (Piton), an arthroscopic technology for rotator cuff repair. The Piton was based on technology developed by Sapphire Medical, Inc. (Sapphire). In April 2007, C2M Medical, Inc. (C2M) acquired all the assets related to the Piton technology from Sapphire. C2M was a company founded and owned by certain then current shareholders of the Company. The Company had no equity ownership interest in C2M.

Under the terms of the purchase agreement between C2M and Sapphire, C2M paid Sapphire \$7.5 million upon execution of the transaction. C2M also agreed to pay Sapphire a \$5.0 million milestone payment upon completion of 75 surgeries using the Piton and a separate \$7.5 million milestone payment once the Piton was commercially launched to the sales force. These milestones were paid by C2M during 2008. Additionally, C2M agreed to pay Sapphire an earnout equal to 25% of Piton sales for the first three years after launch.

## Table of Contents

In January 2008, the Company began negotiating a licensing agreement with C2M for use of its Piton technology to launch as an anchor product in the Company's newly developed sports medicine product portfolio. In June 2008, the Company executed an exclusive worldwide license agreement with C2M for use of the Piton technology. The terms of the agreement called for the Company to assume the remaining obligation of C2M under its purchase agreement with Sapphire related to future earnout payments equal to 25% of Piton sales for the three-year period after product launch. C2M had the right to terminate the license agreement at any time after 18 months from the execution of the license. The terms of the license also included an option purchase agreement (the Option Agreement) that allowed the Company to purchase 100% of the common stock of C2M once cumulative Piton sales reach \$5.0 million or C2M terminated the license (the Call Option). Additionally, the license included a clause, whereby C2M could require the Company to purchase 100% of C2M's common stock if sales of the Piton anchor products exceeded \$5.0 million (the Put Option). Under both the Call Option and the Put Option, the purchase price of C2M would be equal to the paid-in capital of C2M and was required to be paid in the Company's ordinary shares. The paid-in capital of C2M as of December 2008 and 2009 was approximately \$23.2 million, which consisted of the purchase price paid to Sapphire for the Piton technology, including milestones paid, and an additional amount of capital to fund development activities.

The Company determined that C2M was a variable interest entity as of June 2008. The Option Agreement allowed for the Company to purchase C2M at a fixed price regardless of the actual performance of the Piton products. As a result, C2M did not have the right to receive expected residual returns that would instead be enjoyed by the Company. The Company was considered the primary beneficiary of C2M because it had the obligation to absorb the majority of the expected losses and the right to absorb the majority of the expected returns. As a result, the Company was required to consolidate C2M. This conclusion was reached due to the existence of the Put Option and Call Option to acquire C2M at a price that was fixed upon entry into the license agreement. Accordingly, the financial position and results of operations of C2M have been included in the consolidated financial statements from the date of execution of the license agreement. The liabilities recognized as a result of consolidating C2M consist primarily of the fair value of the obligations C2M had under its purchase agreement with Sapphire. As of October 2, 2011 and January 2, 2011, the only material liability recognized relates to the estimated remaining earnout payments due under the original Sapphire purchase agreement. The Company is required to make these earnout payments on behalf of C2M in accordance with the license agreement. The assets of C2M consist of only cash used to fund ongoing operations and the Piton technology intangible asset.

Pursuant to authoritative guidance, the equity interests in C2M not owned by the Company were reported as non-controlling interests on the consolidated balance sheet of the Company. Losses incurred by C2M are charged to the Company and to the non-controlling interest holders based on their ownership percentage. Prior to the acquisition of the noncontrolling interest by the Company, the non-controlling interest holders held 100% of the equity interests in C2M, and therefore, none of the results of operations are allocated to the Company. Therefore, the noncontrolling interest was accounted for in the consolidated financial statements as a contingently redeemable non-controlling interest that is initially recorded at fair value and classified as mezzanine equity.

However, pursuant to authoritative guidance, if the fair value of the contingently redeemable non-controlling interest is less than the current redemption value, and it is probable that the contingency related to the Put Option will be met, then the carrying value of the contingently redeemable non-controlling interest must be adjusted to its redemption value through a charge directly to equity. The Company recognized \$0.7 million in accretion charges during the fiscal nine month period ended October 3, 2010, to reflect the contingently redeemable non-controlling interest at its current redemption value as it is probable the \$5 million sales contingency included in the Put Option would be met. No such accretion charges were recorded during the nine month period ended October 2, 2011. The Company recognized \$0.7 million in net losses during the nine month period ended October 3, 2010 as a result of the consolidation of C2M. These net losses consist primarily of intangible asset amortization and, as such, the results of consolidation of C2M did not have a significant impact on the consolidated cash flows of the Company.

During the first quarter of 2010, the Company exercised its Call Option to acquire the outstanding shares of C2M in exchange for the Company's ordinary shares. The transaction represents the acquisition of a non-controlling interest and as a result was accounted for as an equity transaction in accordance with Accounting Standards Codification (ASC) 810-10. Upon exercise of the Call Option, a non-controlling interest in C2M no longer existed. The balance of the non-controlling interest was eliminated and the fair value of the ordinary shares issued in the acquisition, \$23.2 million, was recorded as a component of shareholders' equity.

The earnout period related to the obligation to pay to Sapphire 25% of all Piton sales ended September 30, 2011. The Company had originally recorded a contingent liability at the time of the consolidation of C2M based on the estimated fair value of the liability at that time. Upon completion of the earnout period, the Company reversed the remaining liability balance and recognized a \$1.0 million gain on extinguishment of this contingency. The gain is recorded in other non-operating income (expense) within the statement of operations.

Table of Contents

**15. Litigation**

On October 25, 2007, two of the Company's former sales agents filed a complaint in the U.S. District Court for the Southern District of Illinois, alleging that the Company had breached their agency agreements and committed fraudulent and negligent misrepresentations. The jury rendered a verdict on July 31, 2009, awarding the plaintiffs a total of \$2.6 million in actual damages and \$4.0 million in punitive damages. While the court struck the award of punitive damages on March 31, 2010, it denied the Company's motion to set aside the verdict or order a new trial. The Company timely filed a notice of appeal with the U.S. Court of Appeals for the Seventh Circuit in respect of the remaining actual damages. On August 24, 2011, the U.S. Court of Appeals for the Seventh Circuit issued its decision affirming the order of the lower court setting aside the award of punitive damages. In addition, the appellate court affirmed the lower court's finding of liability against the Company, but vacated the lower court's damages award of \$2.6 million in compensatory damages as being not supported by the record and being too speculative. The case has been remanded to the lower court for a recalculation of damages that is consistent with the appellate court's decision. The parties are currently awaiting an order from the lower court setting forth the procedure for the remand proceedings.

The Company has considered the facts of the case, the related case law and the decision of the U.S. Court of Appeals for the Seventh Circuit and, based on this information, believes that the verdict rendered on July 31, 2009 was inappropriate given the related facts and supporting legal arguments. The Company has considered the progress of the case, the views of legal counsel the facts and arguments presented at the original jury trial, and the decision of the U.S. Court of Appeals for the Seventh Circuit and the fact that the Company intends to continue to vigorously defend its position through the remand proceedings in assessing the probability of a loss occurring for this matter. The Company believes it must assess the probability of the incurrence of a loss, and the ability to reasonably estimate such loss, based on the possible outcomes of the entire legal process including the remand and appeals process. The Company believes its legal position is strong and that the range of possible outcomes is between zero and \$2.6 million. After assessing all relevant information, the Company does not believe there to be a reasonably estimable loss within the range of possible outcomes that is probable of occurring. As a result, the Company has not recorded an accrual for any loss related to this issue. The Company has determined that a loss is reasonably possible, and management estimates the range of loss to be between zero and \$2.6 million, the amount of the initial jury verdict, minus the punitive damage award. The Company believes it continues to have a strong defense against these claims and is vigorously contesting these allegations. As of October 2, 2011, no accrual was recorded relating to this case.

In addition to the item noted above, the Company is subject to various other legal proceedings, product liability claims and other matters which arise in the ordinary course of business. In the opinion of management, the amount of liability, if any, with respect to these matters will not materially affect the Company's consolidated financial statements.

**16. Special Charges**

During the year ended December 27, 2009, the Company consolidated its U.S. operations and closed quality and regulatory sales and marketing functions in San Diego, California and manufacturing operations in Beverly, Massachusetts. Additionally, the Company opened sales offices in Scandinavia and the United Kingdom in 2009. The Company incurred \$1.9 million in costs related to the consolidation and launching of the sales sites. The operating costs for Scandinavia and the United Kingdom are included in sales and marketing expense. Included in the \$1.9 million of special charges are expenses incurred related to severance, lease termination, and moving costs related to consolidation of the Company's U.S. operations, as well as expenses for travel, consulting, and legal costs incurred to launch the sales sites. All expenses were paid in 2009.

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During the third quarter of 2011, the Company recorded \$0.1 million in special charges for severance related expenses related to the Company's consolidation of the remaining quality, manufacturing and product development functions at its Beverly, Massachusetts facility.

### 17. Subsequent Events

The Company has evaluated subsequent events after October 2, 2011 and concluded that no material transactions occurred subsequent to that date that provided additional evidence about conditions that existed at or after October 2, 2011 that require adjustment to the consolidated financial statements.

Table of Contents

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

You should read the following discussion of our financial condition and results of operations together with the consolidated financial statements and the notes thereto included elsewhere in this report, and other financial information included in this report. The following discussion may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed under "Special Note Regarding Forward-Looking Statements" and elsewhere in this report. These risks could cause our actual results to differ materially from any future performance suggested below.

Our fiscal quarters are generally determined on a 13-week basis and always end on a Sunday. As a result, our fiscal year is generally 364 days. Our year-end periods end on the Sunday nearest to December 31. Every few years, it is necessary to add an extra week to a quarter to make it a 14-week period in order to have our year end fall on the Sunday nearest to December 31. For example, the first three quarters of 2010 include an extra week of operations compared to the first three quarters of 2011. For purposes of this management's discussion and analysis of financial condition and results of operations, references to:

- the third quarter of 2011 or three months ended October 2, 2011 refers to the 13-week period ended October 2, 2011;
- the first three quarters of 2011 or nine months ended October 2, 2011 refers to the 39-week period ended October 2, 2011;
- the third quarter of 2010 or the three months ended October 3, 2010 refers to the 13-week period ended October 3, 2010; and
- the first three quarters of 2010 or nine months ended October 3, 2010 refers to the 40-week period ended October 3, 2010.

**Overview**

We are a global medical device company focused on surgeons that treat musculoskeletal injuries and disorders of the shoulder, elbow, wrist, hand, ankle and foot. We refer to these surgeons as extremity specialists. We sell to this extremity specialist customer base a broad line of joint replacement, trauma, sports medicine and biologic products to treat extremity joints. Our motto of "specialists serving specialists" encompasses this focus. In certain international markets, we also offer joint replacement products for the hip and knee. We currently sell approximately 90 product lines in approximately 35 countries.

We believe we are differentiated by our full portfolio of upper and lower extremity products, our dedicated extremity-focused sales organization and our strategic focus on extremities. We further believe that we are well positioned to benefit from the opportunities in the extremity products marketplace as we are among the global leaders in the shoulder and ankle joint replacement markets. We have also expanded our technology base and product offering to include: new joint replacement products based on new materials; improved trauma products based on innovative designs; and proprietary biologic materials for soft tissue repair. In the United States, which is the largest orthopaedic market, we believe that our single, "specialists serving specialists" distribution channel is strategically aligned with what we believe is an ongoing trend in orthopaedics for surgeons to specialize in certain parts of the anatomy or certain types of procedures.



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Our principal products are organized in four major categories: upper extremity joints and trauma, lower extremity joints and trauma, sports medicine and biologics, and large joints and other. Our upper extremity joints and trauma products include joint replacement and bone fixation devices for the shoulder, hand, wrist and elbow. Our lower extremity joints and trauma products include joint replacement and bone fixation devices for the foot and ankle. Our sports medicine and biologics product category includes products used across several anatomic sites to repair or regenerate soft tissue. Our large joints and other products include hip and knee joint replacement implants and ancillary products.

In the United States, we sell products from our upper extremity joints and trauma, lower extremity joints and trauma, and sports medicine and biologics product categories; we do not market large joints in the United States nor do we currently have plans to do so. While we market our products to extremity specialists, our revenue is generated from sales to healthcare institutions and distributors. We sell through a single sales channel consisting of a network of independent commission-based sales agencies, with occasional variations based upon individual territories. Internationally, in select markets, we sell our full product portfolio, including upper extremity joints and trauma, lower extremity joints and trauma, sports medicine and biologics and large joints. We utilize several distribution approaches depending on the individual market requirements, including direct sales organizations in the largest European markets and independent distributors for most other international markets.

We have significantly grown our business during the past several years and have built an extremities focused business that offers a broad range of products to a focused group of specialty surgeons. We believe this strategy has been the primary factor in enabling our revenue growth during such time. During the past several years we also have increased our operating expenses significantly. We have strategically invested with particular emphasis on product development, acquisition of strategic products and technologies, manufacturing capacity, sales commissions and infrastructure to support both current and anticipated future growth.

Table of Contents

**Foreign Currency Exchange Rates**

A substantial portion of our business is located outside the United States and as a result we generate revenue and incur expenses denominated in currencies other than the U.S. dollar. The majority of our operations denominated in currencies other than the U.S. dollar are denominated in Euros. In the first three quarters of 2011 and 2010, 46% and 43%, of our revenues, respectively, were denominated in foreign currencies. As a result, our revenue can be significantly impacted by fluctuations in foreign currency exchange rates. We expect that foreign currencies will continue to represent a similarly significant percentage of our revenues in the future. Selling, marketing and administrative costs and research and development costs related to these revenues are largely denominated in the same foreign currencies, thereby limiting our foreign currency transaction risk exposure. We, therefore, believe that the risk of a significant impact on our earnings from foreign currency fluctuations is mitigated to some extent.

A substantial portion of the products we sell in the United States are manufactured in countries where costs are incurred in Euros. Fluctuations in the Euro to U.S. dollar exchange rate will have an impact on the cost of the products we manufacture in those countries, but we would not likely be able to change our U.S. dollar selling prices of those same products in the United States in response to those cost fluctuations. As a result, fluctuations in the Euro to U.S. dollar exchange rates could have a significant impact on the cost of the inventory produced and a related impact on our gross profit in the future periods in which that inventory is sold. Fluctuations in the value of foreign currencies relative to the U.S. dollar impact our operating results. Impacts associated with fluctuations in foreign currency exchange rates are discussed in more detail under

Item 3 Quantitative and Qualitative Disclosures about Market Risk. In countries with currencies other than the U.S. dollar, assets and liabilities are translated into U.S. dollars using end-of-period exchange rates; and revenues, expenses and cash flows are translated using average rates of exchange. Constant currency growth rates used in the following discussion of results of operations eliminate the impact of period-over-period foreign currency fluctuations.

We evaluate our results of operations on both an as reported and a constant currency basis. The constant currency presentation is a non-GAAP financial measure, which excludes the impact of fluctuations in foreign currency exchange rates. We believe providing constant currency information provides valuable supplemental information regarding our results of operations, consistent with how we evaluate our performance. We calculate constant currency percentages by converting our current-period local currency financial results using the prior-period foreign currency exchange rates and comparing these adjusted amounts to our prior-period reported results. This calculation may differ from similarly-titled measures used by others; and, accordingly, the constant currency presentation is not meant to be a substitution for recorded amounts presented in conformity with GAAP nor should such amounts be considered in isolation.

**Results of Operations**

*Comparison of three months ended October 2, 2011 to three months ended October 3, 2010*

The following table sets forth, for the periods indicated, our results of operations as a percentage of revenue:

	Three months ended	
October 2,	October 3,	
2011	2010	

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Revenue	100%	100%
Cost of goods sold	29%	27%
Gross profit	71%	73%
Operating expenses:		
Selling and marketing	55%	59%
General and administrative	11%	11%
Research and development	7%	8%
Amortization of intangible assets	5%	6%
Special charges	0%*	0%*
Operating loss	(7)%	(11)%

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\* Not meaningful

The following tables set forth, for the periods indicated, our revenue by product category and geography expressed as dollar amounts and the changes in revenue between the specified periods expressed as percentages:

Table of Contents

Revenue by Product Category	Three months ended		Percent change (as reported)	Percent change (constant currency)
	October 2, 2011	October 3, 2010		
	(\$ in thousands)			
Upper extremity joints and trauma	\$ 37,690	\$ 31,990	17.8%	14.2%
Lower extremity joints and trauma	5,943	5,558	6.9%	4.3%
Sports medicine and biologics	3,329	3,170	5.0%	1.6%
Total extremities	46,962	40,718	15.3%	11.9%
Large joints and other	10,594	8,989	17.9%	6.7%
Total	\$ 57,556	\$ 49,707	15.8%	10.9%

Revenue by Geography	Three months ended		Percent change (as reported)	Percent change (constant currency)
	October 2, 2011	October 3, 2010		
	(\$ in thousands)			
United States	\$ 32,781	\$ 30,132	8.8%	8.8%
International	24,775	19,575	26.6%	14.3%
Total	\$ 57,556	\$ 49,707	15.8%	10.9%

*Revenue.* Revenue increased by 15.8% to \$57.6 million during the three months ended October 2, 2011 from \$49.7 million during the three months ended October 3, 2010, as a result of increased sales in each of our product categories, with the most significant increase occurring in our upper extremity joints and trauma and large joints and other categories. The growth across all product categories was due primarily to increased demand and product expansion and was impacted favorably by fluctuations in foreign currency exchange rates. Our overall revenue growth of 15.8% consisted of 8.8% growth in the United States and 26.6% growth in our international geographies. Excluding the impact of foreign currency exchange rate fluctuations, overall revenue growth was 10.9%.

*Revenue by product category.* Revenue in upper extremity joints and trauma increased by 17.8% to \$37.7 million during the three months ended October 2, 2011 from \$32.0 million during the three months ended October 3, 2010, primarily as a result of the continued increase in sales of our Aequalis Reverse and Aequalis Ascend shoulder products. We believe that increased sales of our Aequalis shoulder products resulted from continued market growth in shoulder replacement procedures and continued market adoption of reversed shoulder replacement procedures. We also saw an increase in sales of our Ascend shoulder product which continued to gain share in the shoulder replacement market. Revenue in lower extremity joints and trauma increased by 6.9% to \$5.9 million during the three months ended October 2, 2011 from \$5.6 million during the three months ended October 3, 2010, due to increased sales in our ankle replacement products in both the United States and internationally and increased sales of our foot and ankle fixation products due to expanded instrument set availability for key new products such as the Stabilis Ankle Fusion System. Revenue in sports medicine and biologics increased by 5.0% to \$3.3 million during the three months ended October 2, 2011 from \$3.2 million during the three months ended October 3, 2010, as a result of increased sales of our anchor products internationally. Revenue in large joints and other increased by 17.9% to \$10.6 million during the three months ended October 2, 2011 from \$9.0 million during the three months ended October 3, 2010, primarily due to increased sales of hip and knee products in France and certain export markets. The growth in all our product categories was also significantly impacted favorably by fluctuations in foreign currency exchange rates due to the weakening of the U.S. Dollar versus the Euro. The product category that was most significantly impacted by fluctuations in foreign currency exchange rates was the large joints and other category. Excluding the impact of foreign currency exchange rate fluctuations, our large joints and other category experienced a 6.7% growth rate. The majority of our large joints and other revenue is denominated in foreign currency; and is, therefore, the product category most significantly impacted by foreign currency fluctuations.

*Revenue by geography.* Revenue in the United States increased by 8.8% to \$32.8 million during the three months ended October 2, 2011 from \$30.1 million during the three months ended October 3, 2010, primarily driven by continued increase in sales in upper extremity joints and trauma products including, in particular, our Aequalis and Ascend shoulder replacement products. The United States revenue increase was also

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impacted by increases in sales of our ankle fixation products driven by expanded instrument set availability of key new products such as the Stabilis Ankle Fusion System. International revenue increased by 26.6% to \$24.8 million during the three months ended October 2, 2011 from \$19.6 million during the three months ended October 3, 2010, primarily due to increased sales in upper extremities joints and trauma products in France, Australia, Germany, Switzerland and The Netherlands, increased sales of large joints and other products in France, and sales to certain stocking distributors across various countries in which we have no current direct sales force. International revenue was also impacted favorably by fluctuations in foreign currency exchange rates. Excluding the impact of foreign currency exchange rate fluctuations, international revenue growth was 14.3%.

*Cost of goods sold.* Our cost of goods sold increased by 23% to \$16.7 million during the three months ended October 2, 2011 from \$13.6 million during the three months ended October 3, 2010. As a percentage of revenue, cost of goods sold increased to 29% during the three months ended October 2, 2011 from 27% during the three months ended October 3, 2010, primarily due to a change in geographical revenue mix and product mix within geographies. Our international revenue generally results in a higher level of cost of goods sold as a percentage of revenue than our United States revenue due to the differences in selling prices in various countries.

Table of Contents

Our international revenue represented 43% of total revenue during the third quarter of 2011 compared to 39% during the third quarter of 2010. Our cost of goods sold and corresponding gross profit as a percentage of revenue can be expected to fluctuate in future periods depending upon certain factors, including, among others, changes in our product sales mix and prices, distribution channels and geographies, manufacturing yields, plans for insourcing some previously outsourced manufacturing, inventory reserves required, levels of production volume and fluctuating inventory costs due to changes in currency exchange rates since the period they were manufactured.

*Selling and marketing.* Our selling and marketing expenses increased by 8% to \$31.8 million during the three months ended October 2, 2011 from \$29.5 million during the three months ended October 3, 2010. As a percentage of revenue, selling and marketing expenses decreased to 55% during the three months ended October 2, 2011 compared to 59% during the three months ended October 3, 2010. As a percentage of revenue, selling and marketing expenses decreased due to our ability to leverage our existing sales and marketing operations with controlled expense increases. The increase in total expense is primarily a result of \$1.4 million related to foreign currency exchange rate fluctuations and \$1.2 million of additional variable selling related expenses such as commissions, royalties and freight on our higher revenue base. Excluding the impact of foreign currency exchange rate fluctuations, the remaining selling and marketing related expenses remained relatively consistent with prior year levels.

*General and administrative.* Our general and administrative expenses increased by 13% to \$6.2 million during the three months ended October 2, 2011 from \$5.4 million during the three months ended October 3, 2010. As a percentage of revenue, general and administrative expenses were 11% during the three months ended October 2, 2011 and the three months ended October 3, 2010. Total general and administrative expenses increased at a rate close to the rate of revenue growth causing general and administrative expenses as a percent of revenue to remain consistent with the prior year. The increase in total expense was due to additional legal, audit and administrative fees incurred as a result of being a U.S. public reporting company as well as increased stock compensation expense. The increase also included \$0.2 million related to foreign currency exchange rate fluctuations.

*Research and development.* Our research and development expenses increased by 11% to \$4.3 million during the three months ended October 2, 2011 from \$3.9 million during the three months ended October 3, 2010. As a percentage of revenue, research and development expenses decreased to 7% during the three months ended October 2, 2011 compared to 8% during the three months ended October 3, 2010. Research and development expense, as a percentage of revenue, decreased compared to the prior year due primarily to the timing of various project related expenses. The increase in total expense compared to the prior year was the result of increased clinical study related expenses as well as \$0.2 million related to foreign currency exchange rate fluctuations. We anticipate that in the near future, our research and development expenses as a percentage of revenue will remain consistent with past levels.

*Amortization of intangible assets.* Amortization of intangible assets decreased by 4% to \$2.7 million during the three months ended October 2, 2011 from \$2.8 million during the three months ended October 3, 2010 as a result of the complete amortization of certain license related intangibles.

*Special charges.* We recorded special charges of \$0.1 million during the third quarter of 2011, which were primarily related to the closure of our Beverly, Massachusetts facility. Special charges during the third quarter of 2010 were also \$0.1 million related to the relocation of our U.S. headquarters and the establishment of our sales office in the United Kingdom.

*Interest expense.* Our interest expense decreased by 93% to \$0.4 million during the three months ended October 2, 2011 from \$5.3 million during the three months ended October 3, 2010 as a result of the repayment of our notes payable in February 2011. Our notes payable carried an 8% stated interest rate and were recorded at a discount because they were issued together with warrants. The discount on our notes payable was

previously also amortized as additional interest expense. As a result, the existence of our notes payable in prior periods caused a much higher level of interest expense.

*Foreign currency transaction loss.* Our foreign currency transaction loss was \$0.2 million during the three months ended October 2, 2011 compared to a loss of \$3.7 million during the three months ended October 3, 2010. Our foreign currency transaction gains and losses recognized during the quarter relate to various foreign currency denominated intercompany balances between our various global operating entities. We currently attempt to mitigate our foreign currency transaction gains and losses by holding similar levels of foreign currency related assets and liabilities. The primary driver of our foreign currency transaction loss in the third quarter of 2010 was related to the revaluation of a foreign currency denominated intercompany note agreement between our U.S. operating entity and one of our European entities. We settled this intercompany arrangement during the first quarter of 2011 thereby eliminating the previously existing foreign currency related exposure.

*Other non-operating income.* Our other non-operating income was \$1.0 million during the third quarter of 2011, compared to \$0.3 million during the third quarter of 2010. Our non-operating income for the third quarter of 2011 is primarily related to recognition of a gain on the resolution of our contingent liability recorded from the prior consolidation and acquisition of C2M. The contingent liability related to remaining earnout payments on sales of our Piton products. This earnout period ended during the third quarter of 2011 and the remaining liability was reversed as a gain recognized in the same quarter.

Table of Contents

*Income tax benefit.* Our effective tax rate was 56% for the third quarter of 2011 and 11% for the third quarter of 2010. The change in our effective tax rate from the third quarter of 2010 to the third quarter of 2011 primarily relates to the relative percentage of our pre-tax loss made up by our U.S. and international operations. During the third quarters of 2011 and 2010 we recognized income tax benefit related to pre-tax losses recognized in certain of our international jurisdictions. In both periods, given our history of operating losses, we did not record a provision for income taxes in the U.S. and certain of our European sales offices.

***Comparison of nine months ended October 2, 2011 to nine months ended October 3, 2010***

The following table sets forth, for the periods indicated, our results of operations as a percentage of revenue:

	Nine months ended	
	October 2, 2011	October 3, 2010
Revenue	100%	100%
Cost of goods sold	28%	27%
Gross profit	72%	73%
Operating expenses:		
Selling and marketing	53%	56%
General and administrative	10%	10%
Research and development	8%	8%
Amortization of intangible assets	4%	5%
Special charges	0%*	0%*
Operating loss	(3)%	(7)%

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\* Not meaningful

The following tables set forth, for the periods indicated, our revenue by product category and geography expressed as dollar amounts and the changes in revenue between the specified periods expressed as percentages:

Revenue by Product Category	Nine months ended		Percent change (as reported)	Percent change (constant currency)
	October 2, 2011	October 3, 2010		
	(\$ in thousands)			
Upper extremity joints and trauma	\$ 120,640	\$ 102,577	17.6%	14.7%
Lower extremity joints and trauma	19,023	17,406	9.3%	6.9%
Sports medicine and biologics	10,769	9,687	11.2%	8.4%
Total extremities	150,432	129,670	16.0%	13.2%
Large joints and other	41,717	36,443	14.5%	6.9%
Total	\$ 192,149	\$ 166,113	15.7%	11.8%



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Revenue by Geography	Nine months ended		Percent change (as reported)	Percent change (constant currency)
	October 2, 2011	October 3, 2010		
	(\$ in thousands)			
United States	\$ 104,197	\$ 94,597	10.1%	10.1%
International	87,952	71,516	23.0%	14.0%
Total	\$ 192,149	\$ 166,113	15.7%	11.8%

*Revenue.* Revenue increased by 15.7% to \$192.1 million during the nine months ended October 2, 2011 from \$166.1 million during the nine months ended October 3, 2010, as a result of increased sales in each of our product categories, with the most significant increase occurring in our upper extremity joints and trauma category. Growth across all product categories was due primarily to increased demand and favorable fluctuations in foreign currency exchange rates and was partially offset by the existence of an extra week of sales in the first nine months of 2010. Our overall revenue growth of 15.7% consisted of 10.1% growth in the United States and 23.0% growth in our international geographies. Excluding the impact of foreign currency exchange rate fluctuations, overall revenue growth was 11.8%.

Table of Contents

*Revenue by product category.* Revenue in upper extremity joints and trauma increased by 17.6% to \$120.6 million during the nine months ended October 2, 2011 from \$102.6 million during the nine months ended October 3, 2010, primarily as a result of the continued increase in sales of our Aequalis Reverse and Aequalis Ascend shoulder products. We believe that increased sales of our Aequalis shoulder products resulted from continued market growth in shoulder replacement procedures and continued market movement towards reversed shoulder replacement procedures. We also saw an increase in sales of our Ascend shoulder products which continued to gain share in the shoulder replacement market. Revenue in lower extremity joints and trauma increased by 9.3% to \$19.0 million during the nine months ended October 2, 2011 from \$17.4 million during the nine months ended October 3, 2010, primarily due to increased sales in our ankle replacement products in both the United States and internationally increased sales of our foot and ankle fixation products due to expanded instrument set availability for key new products such as the Stabilis Ankle Fusion System. Revenue in sports medicine and biologics increased by 11.2% to \$10.8 million during the nine months ended October 2, 2011 from \$9.7 million during the nine months ended October 3, 2010, as a result of increased sales of our suture and anchor products internationally. Revenue in large joints and other increased by 14.5% to \$41.7 million during the nine months ended October 2, 2011 from \$36.4 million during the nine months ended October 3, 2010, primarily due to increased sales of hip and knee products in France and certain export markets. The growth in all of our product categories was favorably impacted by fluctuations in foreign currency exchange rates primarily due to the weakening of the U.S. dollar versus the Euro.

*Revenue by geography.* Revenue in the United States increased by 10.1% to \$104.2 million during the nine months ended October 2, 2011 from \$94.6 million during the nine months ended October 3, 2010, primarily driven by continued increase in sales in upper extremity joints and trauma products including in particular our Aequalis and Ascend shoulder replacement products. The U.S. revenue increase was also impacted by increases in sales of our ankle fixation products. International revenue increased by 23.0% to \$88.0 million during the nine months ended October 2, 2011 from \$71.5 million during the nine months ended October 3, 2010, primarily due to increased revenue in France, Australia, Germany and sales to certain stocking distributors. In each geography, the factors driving the increased sales were partially offset by the existence of an extra week of sales in the first nine months of 2010. Foreign currency exchange rate fluctuations also had a favorable impact on international revenue growth during the first three quarters of 2011. Excluding the impact of foreign currency exchange rate fluctuations, international revenue growth was 14.0%.

*Cost of goods sold.* Our cost of goods sold increased by 20% to \$54.7 million during the nine months ended October 2, 2011 from \$45.6 million during the nine months ended October 3, 2010. As a percentage of revenue, cost of goods sold increased to 28% during the nine months ended October 2, 2011 from 27% during the nine months ended October 3, 2010, primarily due to a change in geographical revenue mix. Our international revenue generally results in a higher level of cost of goods sold as a percentage of revenue than our United States revenue due to the differences in selling prices in various countries. Our international revenue represented 46% of total revenue during the nine months ended October 2, 2011 compared to 43% during the nine months ended October 3, 2010. Our cost of goods sold and corresponding gross profit as a percentage of revenue can be expected to fluctuate in future periods depending upon certain factors, including, among others, changes in our product sales mix and prices, distribution channels and geographies, manufacturing yields, inventory reserves required, levels of production volume and fluctuating inventory costs due to changes in foreign currency exchange rates since the period they were manufactured.

*Selling and marketing.* Our selling and marketing expenses increased by 8% to \$101.3 million during the nine months ended October 2, 2011 from \$93.7 million during the nine months ended October 3, 2010. As a percentage of revenue, selling and marketing expense decreased to 53% during the nine months ended October 2, 2011 from 56% during the nine months ended October 3, 2010. As a percentage of revenue, selling and marketing expenses decreased due to our ability to leverage our existing sales and marketing operations with controlled expense increases. The increase in total expense is primarily a result of \$3.4 million related to foreign currency exchange rate fluctuations, \$3.7 million of increased variable selling expenses such as commissions, royalties and freight, and an increased level of instrument related depreciation and maintenance expenses. Excluding the impact of foreign currency exchange rate fluctuations, the remaining selling and marketing related expenses remained relatively consistent with prior year levels.

*General and administrative.* Our general and administrative expenses increased by 12% to \$18.6 million during the nine months ended October 2, 2011 from \$16.6 million during the nine months ended October 3, 2010. As a percentage of revenue, general and administrative expenses remained at 10% during the nine month periods ended October 2, 2011 and October 3, 2010. The increase was due primarily to

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additional legal, audit and administrative fees incurred as a result of being a U.S. public reporting company. Total general and administrative expenses increased at a rate close to the rate of revenue growth causing general and administrative expenses as a percent of revenue to remain consistent with the prior year. The increase in total expense was due to additional legal, audit and administrative fees incurred as a result of being a U.S. public reporting company as well as increased stock compensation expense. The increase also included \$0.5 million related to foreign currency exchange rate fluctuations.

*Research and development.* Our research and development expenses increased by 15% to \$14.6 million during the nine months ended October 2, 2011 from \$12.7 million during the nine months ended October 3, 2010. As a percentage of revenue, research and development expenses remained at 8% during the nine months ended October 2, 2011 and the nine months ended October 3, 2010. We believe that continued investment in research and development is an important part of sustaining our growth strategy through new product development and anticipate that in the near future, research and development expenses as a percentage of revenue will remain consistent with past levels. The increase in total expenses was the result of increased clinical study related

Table of Contents

expenses and certain biologic related development projects as well as \$0.4 million related to foreign currency exchange rate fluctuations.

*Amortization of intangible assets.* Amortization of intangible assets decreased by 3% to \$8.4 million during the nine months ended October 2, 2011 from \$8.7 million during the nine months ended October 3, 2010 as a result of the complete amortization of certain license related intangibles.

*Special charges.* We recorded special charges of \$0.2 million during the nine months ended October 2, 2011 compared to \$0.3 million for the nine months ended October 3, 2010. The special charges in the first three quarters of 2011 were primarily related to the closure of our Beverly, Massachusetts facility. The special charges in the first three quarters of 2010 were primarily related to the relocation of our U.S. headquarters and the establishment of our sales office in the United Kingdom.

*Interest expense.* Our interest expense decreased by 79% to \$3.3 million during the nine months ended October 2, 2011 from \$16.0 million during the nine months ended October 3, 2010 as a result of the repayment of our notes payable in February 2011. Our notes payable carried an 8% stated interest rate and were recorded at a discount because they were issued together with warrants. The discount on our notes payable was previously also amortized as additional interest expense. As a result, the existence of our notes payable in prior periods caused a much higher level of interest expense.

*Foreign currency transaction loss.* Our foreign currency transaction loss was \$0.1 million during the nine months ended October 2, 2011 compared to a loss of \$9.5 million during the nine months ended October 3, 2010. Our foreign currency transaction gains and losses recognized during the quarter relate to various foreign currency denominated intercompany balances between our various global operating entities. We currently attempt to mitigate our foreign currency transaction gains and losses by holding similar levels of foreign currency related assets and liabilities. The primary driver of our foreign currency transaction loss in the first three quarters of 2010 was related to the revaluation of our warrant liability which was denominated in a currency other than our functional currency. We settled our warrant liability in May 2010 by exchanging all the outstanding warrants for our ordinary shares.

*Loss on extinguishment of debt.* We recognized a \$29.5 million loss on extinguishment of debt during the nine months ended October 2, 2011 due to the repayment of our notes payable. Our notes payable were issued in 2008 and 2009 together with warrants to purchase ordinary shares of the company. At the time of issuance, we recognized the estimated fair value of the warrants as a warrant liability with an offsetting debt discount to reduce the carrying value of the notes payable to the estimated fair value at the time of issuance. This debt discount was then amortized as additional interest expense over the term of the notes. At the time of repayment in the first quarter of 2011, we wrote-off the remaining unamortized portion of the discount as a loss on the extinguishment of debt. We had no such expense related to the extinguishment of debt during 2010. See Note 9 of our consolidated financial statements for further discussion of the accounting treatment of the notes payable and related warrants.

*Other non-operating income.* Our other non-operating income was \$1.0 million during the nine months ended October 2, 2011 compared to \$0.3 million during the nine months ended October 3, 2010. Our non-operating income for the nine months ended 2011 is primarily related to recognition of a gain on the resolution of our contingent liability recorded from the prior consolidation and acquisition of C2M. The contingent liability related to remaining earnout payments on sales of our Piton products. This earnout period ended during the third quarter of 2011 and the remaining liability was reversed as a gain recognized in the same quarter.

*Income tax benefit.* Our effective tax rate for the first three quarters of 2011 and 2010 was 24% and 14%, respectively. The change in our effective tax rate from the first three quarters of 2010 to the first three quarters of 2011 primarily relates to the relative percentage of our pre-tax loss made up by our French operations. Our income tax benefit increased to \$9.1 million during the first three quarters of 2011 compared to \$5.2 million for the first three quarters of 2010. During the first three quarters of 2011, we recognized \$7.5 million of deferred tax benefit related to the \$29.5 million loss on extinguishment of debt previously discussed. This benefit was the result of reversing the remaining deferred tax liability related to the unamortized debt discount on our notes payable at the time of repayment. The remaining income tax benefit recognized during the first three quarters of 2011 relate primarily to pre-tax losses of certain of our international jurisdictions. Given our history of operating losses, we do not generally record a provision for income taxes in the United States and certain of our European sales offices. Our income tax benefit in the first three quarters of 2010 primarily related to a tax benefit recorded related to our French subsidiaries as well as deferred tax benefit on the amortization of the debt discount recognized on our notes payable.

### **Seasonality and Quarterly Fluctuations**

Our business is seasonal in nature. Historically, demand for our products has been the lowest in our third quarter as a result of the European holiday schedule during the summer months.

We have experienced and expect to continue to experience meaningful variability in our revenue and gross profit among quarters, as well as within each quarter, as a result of a number of factors including, among others, the number and mix of products sold in the quarter and the geographies in which they are sold; the demand for, and pricing of our products and the products of our competitors; the timing of or failure to obtain regulatory clearances or approvals for products; costs, benefits and timing of new product introductions; the level of competition; the timing and extent of promotional pricing or volume discounts; changes in average

Table of Contents

selling prices; the availability and cost of components and materials; number of selling days; fluctuations in foreign currency exchange rates; and impairment and other special charges.

**Liquidity and Capital Resources**

Since inception, we have generated significant operating losses. These, combined with significant charges not related to cash from operations, amortization of acquired intangible assets, and fair value adjustments to our warrant liability, have resulted in an accumulated deficit of \$212.0 million as of October 2, 2011. Historically, our liquidity needs have been met through a combination of sales of our equity securities together with issuances of notes payable and warrants to both current shareholders and new investors and other bank related debt. In February 2011, we completed an initial public offering from which we received net proceeds of approximately \$149.5 million after underwriters discounts, commissions and offering expenses. Our notes payable were repaid in full during the first quarter of 2011 using a portion of these proceeds. Additionally, in March 2011, we sold additional ordinary shares due to the exercise of the underwriters' overallotment option from which we received additional net proceeds of approximately \$12.8 million after underwriters' discounts and commissions and offering expenses.

As of October 2, 2011, we had \$45.3 million in short-term and long-term debt. Certain of these debt agreements include financial covenants that (i) require us to maintain a minimum level of tangible net worth in our U.S. operating subsidiary, (ii) have various levels of performance tests of debt to equity and debt to modified income specifically related to our French operating subsidiary and (iii) restrict our ability to borrow in our U.S. operating subsidiary if there is a default under the agreement, all of which may have an impact on our liquidity. As of October 2, 2011, we were in compliance with all of our financial covenants and expect to remain in compliance during the remainder of 2011.

The following table sets forth, for the periods indicated, certain liquidity measures:

	October 2, 2011	As of (\$ in thousands)	January 2, 2011
Cash and cash equivalents	\$	55,848	\$ 24,838
Working capital		139,687	96,965
Line of credit availability		22,070	11,252

*Operating activities.* Net cash provided by operating activities was \$11.0 million during the nine months ended October 2, 2011 compared to net cash used by operating activities of \$0.5 million during the nine months ended October 3, 2010, primarily driven by improvement in our consolidated net loss adjusted for non-cash items and a reduced use of cash for working capital during the first nine months of 2011 as compared to the first nine months of 2010. During the first nine months of 2011 we also received a \$2.8 million income tax refund in the United States related to a one-time ability to carry income tax losses back to a previous period in which our United States subsidiary had previously paid income taxes.

*Investing activities.* Net cash used in investing activities was \$20.9 million during the nine months ended October 2, 2011 compared to net cash used in investing activities of \$18.0 million during the nine months ended October 3, 2010. The increase in net cash used in investing activities is primarily due to the use of cash from our initial public offering to purchase instruments. This was partially offset by reduced purchases of property, plant and equipment. During the first nine months of 2010 purchases of property, plant and equipment included those to finish

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preparing our French manufacturing facility. The first nine months of both 2011 and 2010 include acquisition-related payments made in accordance with the contingent purchase price of the acquisition of our Piton technology. This purchase agreement required that we make payments equal to 25% of the sales of Piton for a three-year period which ended in the third quarter of 2011. The first nine months of 2010 also included an additional contingent consideration payment made related to a 2007 acquisition upon achievement of a specific revenue milestone related to our Ascend shoulder products. Our industry is capital intensive, particularly as it relates to surgical instrumentation. Historically, our capital expenditures have consisted principally of surgical instruments, purchased manufacturing equipment, research and testing equipment, computer systems and office furniture and equipment.

*Financing activities.* Net cash provided by financing activities was \$42.5 million during the nine months ended October 2, 2011 compared to \$6.6 million during the nine months ended October 3, 2010. The increase in net cash provided by financing activities was due to the receipt of approximately \$168.3 million from the completion of our initial public offering and subsequent exercise of the underwriters' overallotment option, after underwriters' discounts and commissions and offering expenses. This was offset in part by the repayment of notes payable of \$116.1 million with a portion of the net proceeds from our initial public offering. We also used cash to reduce our short-term borrowings under various lines of credit by \$8.2 million.

*Other liquidity information.* We have funded our cash needs since 2006 through the issuance of equity, notes payable and warrants to a group of investors and through our initial public offering. Although it is difficult for us to predict our future liquidity requirements, we believe that our cash balance of approximately \$55.8 million and our existing available credit lines of \$22.1 million as of October 2, 2011 will be sufficient to fund our working capital requirements and operations and permit anticipated capital expenditures during the remainder of 2011. In the event that we would require additional working capital to fund future operations, we

Table of Contents

could seek to acquire that through additional equity or debt financing arrangements which may or may not be available on favorable terms at such time.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, as defined by the rules and regulations of the SEC that have or are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources. As a result, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these arrangements.

**Contractual Obligations and Commitments**

We refer you to the description of our contractual obligations and commitments as of January 2, 2011 as set forth in our annual report on Form 10-K for the fiscal year ended January 2, 2011. There were no material changes to such information since that date through October 2, 2011, other than the repayment of our notes payable in February 2011, as previously described.

**Critical Accounting Policies**

Information on judgments related to our most critical accounting policies and estimates is discussed in Item 7 of our annual report on Form 10-K for the year ended January 2, 2011. Certain of our more critical accounting estimates require the application of significant judgment by management in selecting the appropriate assumptions in determining the estimate. By their nature, these judgments are subject to an inherent degree of uncertainty. We develop these judgments based on our historical experience, terms of existing contracts, our observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. Actual results may differ from these judgments under different assumptions or conditions. Different, reasonable estimates could have been used for the current period. Additionally, changes in accounting estimates are reasonably likely to occur from period to period. Both of these factors could have a material impact on the presentation of our financial condition, changes in financial condition or results of operations. All of our significant accounting policies are more fully described in Note 2 to our consolidated financial statements set forth in our annual report on Form 10-K for the year ended January 2, 2011. There have been no significant changes to the policies related to our critical accounting estimates since January 2, 2011.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to various market risks, which may result in potential losses arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rate fluctuations. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We believe we are not exposed to a material market risk with respect to our invested cash and cash equivalents.



## **Interest Rate Risk**

Borrowings under our various revolving lines of credit in the United States and in Europe generally bear interest at variable annual rates. Borrowings under our various term loans in the United States and Europe are mixed between variable and fixed interest rates. As of October 2, 2011, we had \$12.8 million in borrowings under our revolving lines of credit and \$32.6 million in borrowings under various term loans. Based upon this debt level, a 10% increase in the annual interest rate on such borrowings would not have a material impact on our interest expense.

At October 2, 2011, our cash and cash equivalents were \$55.8 million. Based on our annualized average interest rate, a 10% decrease in the annual interest rate on such balances would result in an immaterial impact on an annual basis.

## **Foreign Currency Exchange Rate Risk**

Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies could adversely affect our financial results. In the first three quarters of 2011 and 2010, approximately 46% and 43% of our revenues, respectively, were denominated in foreign currencies. We expect that foreign currencies will continue to represent a similarly significant percentage of our revenues in the future. Operating expenses related to these revenues are largely denominated in the same respective currency, thereby limiting our transaction risk exposure. However, for revenues not denominated in U.S. dollars, if there is an increase in the rate at which a foreign currency is exchanged for U.S. dollars, it will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases and if we price our products in the foreign currency, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our prices not being competitive in a market where business is transacted in the local currency.

During the three and nine months ended October 2, 2011, approximately 78% and 81%, respectively, of our revenues denominated in foreign currencies were derived from EU countries and was denominated in Euros. Additionally, we have significant

Table of Contents

intercompany payables and debt with certain European subsidiaries, which are denominated in foreign currencies, principally the Euro. Our principal exchange rate risk therefore exists between the U.S. dollar and the Euro. Fluctuations from the beginning to the end of any given reporting period result in the remeasurement of our foreign currency-denominated cash, receivables, payables and debt, generating currency transaction gains or losses that impact our non-operating income/expense levels in the respective period and are reported in foreign currency transaction gain (loss) in our consolidated financial statements. We recorded a foreign currency transaction loss of approximately \$0.2 million and \$0.1 million during the three and nine months ended October 2, 2011, respectively, related to the translation of our foreign-denominated receivables, payables and debt into U.S. dollars. We do not currently hedge our exposure to foreign currency exchange rate fluctuations. We may, however, hedge such exposure to foreign currency exchange rates in the future.

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### **Disclosure Controls and Procedures**

Our President and Chief Executive Officer and Global Chief Financial Officer, referred to collectively herein as the Certifying Officers, are responsible for establishing and maintaining our disclosure controls and procedures. The Certifying Officers have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 240.13a-15(e) and 240.15d-15(e) promulgated under the Securities Exchange Act of 1934) as of the end of the period covered in this report. Based on that review and evaluation, which included inquiries made to certain of our other employees, the Certifying Officers have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures, as designed and implemented, are effective in ensuring that information relating to our company required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such information is accumulated and communicated to our management, including the Certifying Officers, as appropriate to allow timely decisions regarding required disclosure.

##### **Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the third quarter of 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

A description of our legal proceedings in Note 15 of our consolidated financial statements included in this report is incorporated herein by reference.

**ITEM 1A. RISK FACTORS.**

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. In addition to the other information set forth in this report, careful consideration should be taken of the factors described in our annual report on Form 10-K for the fiscal year ended January 2, 2011 under the heading Part I Item 1A. Risk Factors, which could materially adversely affect our business, financial condition or operating results. There has been no material change in those risk factors, except for the risk factor below:

*Disruption and turmoil in global credit and financial markets, which may be exacerbated by the inability of certain countries to continue to service their sovereign debt obligations, and the possible negative implications of such events to the global economy, may negatively impact our business, operating results and financial condition.*

The recent downgrade of the U.S. credit rating and the possibility that certain European Union member states will default on their debt obligations have contributed to significant uncertainty about the stability of global credit and financial markets. The credit and economic conditions within certain European Union countries in particular, including Greece, Ireland, Italy, Portugal and Spain, have continued to deteriorate and have contributed to the instability in global credit and financial markets. The possibility that such EU member states will default on their debt obligations, the continued uncertainty regarding international and the European Union's financial support programs and the possibility that other EU member states may experience similar financial troubles could further disrupt global credit and financial markets. While the ultimate outcome of these events cannot be predicted, it is possible that such events could have a negative effect on the global economy as a whole, and our business, operating results and financial condition, in particular. For example, if the European sovereign debt crisis continues or worsens, the negative implications to the global economy and us could be significant. Since a significant amount of our trade receivables are with hospitals that are dependent upon governmental health care systems in many countries, repayment of such receivables is dependent upon the financial stability of the economies of those countries. A deterioration of economic conditions in such countries may increase the average length of time it takes for us to collect on our outstanding accounts receivable in these countries. In addition, if the European sovereign debt crisis continues or worsens, the value of the Euro could deteriorate, which could negatively impact our business, operating results and financial condition in light of our substantial operations in and revenues derived from customers in the European Union. Tightening of the credit and financial markets could negatively impact the ability of companies to borrow money from their existing lenders, obtain credit from other sources or raise financing to fund their operations. This could negatively impact our customers' ability to purchase our products, our suppliers' ability to provide us with materials and components and our ability, if needed, to finance our operations on commercially reasonable terms, or at all. Any or all of these events as well as austerity measures anticipated to be taken in several countries could negatively impact our business, operating results and financial condition.

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

#### **Recent Sales of Unregistered Securities**

During the third quarter of 2011, we did not issue any ordinary shares or other equity securities of our company that were not registered under the Securities Act of 1933, as amended.

#### **Use of Proceeds from Registered Securities**

Our initial public offering was effected through a registration statement on Form S-1 (File No. 333-167370) that was declared effective by the SEC on February 2, 2011. An aggregate of 10,062,500 ordinary shares were registered (including the underwriters' over-allotment of 1,312,500 ordinary shares), of which we sold 8,750,000 shares, at an initial price to the public of \$19.00 per share (before underwriters' discounts and commissions). The offering closed on February 8, 2011, and, as a result, we received net proceeds of approximately \$149.5 million, after underwriters' discounts and commissions of approximately \$10.8 million and offering related expenses of \$5.9 million. Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC were the managing underwriters of the offering. Subsequently, on March 7, 2011, we issued an additional 721,274 ordinary shares at an offering price of \$19.00 per share (before underwriters' discounts and commissions) due to the exercise of the underwriters' overallotment option, and received additional net proceeds of approximately \$12.8 million, after underwriters' discounts and commissions of approximately \$0.9 million. Aggregate gross proceeds from the offering, including the exercise of the over-allotment option, were \$179.9 million and net proceeds received after underwriters' discounts and commissions and offering related expenses were approximately \$162.3 million.

Table of Contents

Through October 2, 2011, we used approximately \$116.1 million ( 86.4 million) of the net proceeds from the offering to repay all of the outstanding indebtedness under our notes payable, including accrued interest thereon. Additionally, through October 2, 2011, we used \$4.3 million of the net proceeds from the offering to purchase instruments and implants and \$16.8 million to reduce our short-term borrowings under our lines of credit. The majority of the \$116.1 million used to repay the outstanding indebtedness under our notes payable, including accrued interest thereon, and none of the \$4.3 million used to purchase instruments and implants or \$16.8 million used to reduce our short-term borrowings under various lines of credit were paid to certain of our directors and officers, or their associates, to persons owning ten percent or more of our outstanding ordinary shares and other affiliates of ours.

We expect to use the remaining net proceeds for general corporate purposes. Pending the uses described above, we have invested the remaining net proceeds in a variety of short-term, interest-bearing, investment grade securities. There has been no material change in the planned use of proceeds from the offering from that described in the final prospectus dated February 2, 2011 filed by us with the SEC pursuant to Rule 424(b)(1).

**Issuer Purchases of Equity Securities**

We did not purchase any ordinary shares or other equity securities of ours during the third quarter of 2011.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

**ITEM 4. [REMOVED AND RESERVED]**

**ITEM 5. OTHER INFORMATION.**

Not applicable.

**ITEM 6. EXHIBITS.**

The following exhibits are filed or furnished with this quarterly report on Form 10-Q:

## Edgar Filing: Tornier N.V. - Form 10-Q

Exhibit No.	Description
10.1	First Amendment of the Tornier N.V. 2010 Employee Stock Purchase Plan (Filed herewith)
10.2	Tornier N.V. 2010 Employee Stock Purchase Plan Sub-Plan for France (Filed herewith)
10.3	Employment Agreement effective as of July 25, 2011 between Tornier, Inc. and David H. Mowry (Filed herewith)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)
101	The following materials from Tornier N.V.'s Quarterly Report on Form 10-Q for the quarter ended October 2, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the unaudited Consolidated Balance Sheets, (ii) the unaudited Consolidated Statements of Operations, (iii) the unaudited Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements (Furnished herewith)*

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\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this quarterly report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under Section 11 or 12 of the Securities Act of 1933, as amended, or otherwise subject to the liability of those sections, except as shall be expressly set forth by specific reference in such filings.

Table of Contents

**SIGNATURES**

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

**TORNIER N.V.**

Date: November 14, 2011

By: /s/ Douglas W. Kohrs  
Douglas W. Kohrs  
*President and Chief Executive Officer*  
(principal executive officer)

Date: November 14, 2011

By: /s/ Carmen L. Diersen  
Carmen L. Diersen  
*Global Chief Financial Officer*  
(principal financial and accounting officer)

Table of Contents

**TORNIER N.V.  
QUARTERLY REPORT ON FORM 10-Q**

**EXHIBIT INDEX**

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