

MIMEDX GROUP, INC.
Form 10-Q
November 13, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2012

OR

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

For the transition period from _____ to _____

Commission file number 0-52491

MIMEDX GROUP, INC.
(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of incorporation)

26-2792552
(I.R.S. Employer Identification Number)

60 Chastain Center Blvd., Suite 60
Kennesaw, GA
(Address of principal executive offices)

30144
(Zip Code)

(678) 384-6720
(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 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 Smaller reporting

company x

(Do not check if a
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 October 31, 2012, there were 86,744,341 shares outstanding of the registrant's common stock.

MIMEDX GROUP, INC.

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Forward-Looking Statements

This Form 10-Q and certain information incorporated herein by reference contain forward-looking statements and information within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, acceptance of the Company’s products by the market, and management’s plans and objectives. In addition, certain statements included in this and our future filings with the Securities and Exchange Commission (“SEC”), in press releases, and in oral and written statements made by us or with our approval, which are not statements of historical fact, are forward-looking statements. Words such as “may,” “could,” “should,” “would,” “believe,” “expect,” “anticipate,” “estimate,” “intend,” “seeks,” “plan,” “project,” “will,” “should,” and other words or expressions of similar meaning are intended by us to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements are found at various places throughout this report and in the documents incorporated herein by reference. These statements are based on our current expectations about future events or results and information that is currently available to us, involve assumptions, risks, and uncertainties, and speak only as of the date on which such statements are made.

All forward-looking statements are subject to the risks and uncertainties inherent in predicting the future. Our actual results may differ materially from those projected, stated or implied in these forward-looking statements as a result of many factors, including our critical accounting policies and risks and uncertainties related to, but not limited to, overall industry environment, delay in the introduction of products, regulatory delays, negative clinical results, and our financial condition. These and other risks and uncertainties are described in more detail in our most recent Annual Report on Form 10-K, as amended, as well as other reports that we file with the SEC.

Forward-looking statements speak only as of the date they are made and should not be relied upon as representing our views as of any subsequent date. We undertake no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur, except as required by applicable laws, and you are urged to review and consider disclosures that we make in this and other reports that we file with the SEC that discuss factors germane to our business.

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Part I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2012 (unaudited)	December 31, 2011
Current assets:		
Cash and cash equivalents	\$ 7,621,226	\$ 4,112,326
Accounts receivable, net	6,170,124	1,891,919
Inventory, net	1,802,335	712,602
Prepaid expenses and other current assets	546,715	164,664
Total current assets	16,140,400	6,881,511
Property and equipment, net of accumulated depreciation of \$2,168,898 and \$1,814,473, respectively	999,866	869,411
Goodwill	4,040,443	4,040,443
Intangible assets, net of accumulated amortization and impairments of \$6,384,656 and \$3,468,515, respectively	12,174,344	15,090,485
Deposits and other long term assets	180,428	214,342
Total assets	\$ 33,535,481	\$ 27,096,192

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable and accrued expenses	\$ 3,750,350	\$ 2,300,638
Other current liabilities	78,634	6,620
Convertible line of credit with related party, net of unamortized discount of \$217,678 and \$46,746, respectively, plus accrued interest of \$91,521 and \$42,726, respectively	1,173,846	1,295,980
Convertible debt related to acquisition, net of unamortized discount of \$170,509, plus accrued interest of \$49,315	-	1,128,806
Current portion of earn-out liability payable In MiMedx common stock	5,545,280	3,185,223
Total current liabilities	10,548,110	7,917,267
Earn-out liability payable in MiMedx common stock, net of current portion	-	4,225,280
Convertible Senior Secured Promissory Notes, net of unamortized discount of \$1,569,592 and \$2,263,145, respectively, plus accrued interest of \$63,133 and \$7,732, respectively	3,493,540	2,744,587
Other liabilities	311,085	312,493
Total liabilities	14,352,735	15,199,627
Commitments and contingencies (Note 12)	-	-

Stockholders' equity:

Preferred stock; \$.001 par value; 5,000,000 shares authorized and 0 shares issued and outstanding	-	-
Common stock; \$.001 par value; 110,000,000 shares authorized; 86,792,175 issued and 86,742,175 outstanding for 2012 and 74,306,895 issued and 74,256,895 outstanding for 2011	86,792	74,307
Additional paid-in capital	87,199,392	73,868,604
Treasury stock (50,000 shares at cost)	(25,000)	(25,000)
Accumulated deficit	(68,078,438)	(62,021,346)
Total stockholders' equity	19,182,746	11,896,565
Total liabilities and stockholders' equity	\$ 33,535,481	\$ 27,096,192

See notes to condensed consolidated financial statements.

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MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2012	2011	2012	2011
REVENUES:				
Net sales	\$ 7,954,046	\$ 2,152,094	\$ 16,544,110	\$ 5,124,980
OPERATING COSTS AND EXPENSES:				
Cost of products sold	1,425,336	886,510	3,499,117	2,441,568
Research and development expenses	838,690	561,545	1,748,847	2,315,721
Selling, general and administrative expenses	6,206,251	2,356,396	12,561,257	7,692,831
Impairment of intangible assets	1,798,495	-	1,798,495	-
Fair value adjustment of earn-out liability	1,320,000	-	1,320,000	-
LOSS FROM OPERATIONS	(3,634,726)	(1,652,357)	(4,383,606)	(7,325,140)
OTHER INCOME (EXPENSE), net				
Financing expense associated with the debt discount recognized in connection with the senior secured promissory notes	(439,064)	(80,689)	(1,222,290)	(214,206)
Interest expense, net	(145,582)	(32,677)	(451,196)	(77,445)
LOSS BEFORE INCOME TAXES	(4,219,372)	(1,765,723)	(6,057,092)	(7,616,791)
Income taxes	-	-	-	-
NET LOSS	\$ (4,219,372)	\$ (1,765,723)	\$ (6,057,092)	\$ (7,616,791)
Net loss per common share				
Basic and diluted	\$ (0.05)	\$ (0.02)	\$ (0.07)	\$ (0.11)
Shares used in computing net loss per common share				
Basic and diluted	84,493,164	73,767,674	84,091,014	72,082,605

See notes to condensed consolidated financial statements.

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MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Nine Months Ended September 30, 2012
(unaudited)

	Convertible Preferred Stock Series A		Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount				
Balances, December 31, 2011	-	\$ -	74,306,895	\$74,307	\$ 73,868,604	\$(25,000)	\$(62,021,346)	\$11,896,565
Employee share-based compensation expense	-	-	-	-	1,432,627	-	-	1,432,627
Other share-based compensation expense	-	-	-	-	323,042	-	-	323,042
Exercise of stock options	-	-	719,000	719	884,315	-	-	885,034
Exercise of warrants	-	-	7,857,266	7,857	5,917,682	-	-	5,925,539
Repurchase warrants	-	-	-	-	(568)	-	-	(568)
Cashless exercise of warrants	-	-	216,085	216	(216)	-	-	-
Common stock issued for accrued director fees	-	-	167,086	167	184,486	-	-	184,653
Common stock issued for earn-out liability	-	-	2,632,576	2,633	3,182,590	-	-	3,185,223
Discount on beneficial	-	-	-	-	514,456	-	-	514,456

conversion feature recognized on line of credit with related party								
Common stock issued for acquisition note	-	-	893,267	893	892,374	-	-	893,267
Net loss for the period	-	-	-	-	-	-	(6,057,092)	(6,057,092)
Balances, September 30, 2012	-	\$ -	86,792,175	\$86,792	\$ 87,199,392	\$(25,000)	\$(68,078,438)	\$19,182,746

See notes to condensed consolidated financial statements.

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MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net loss	\$ (6,057,092)	\$ (7,616,791)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation	354,425	330,851
Amortization of intangible assets	1,117,646	1,001,931
Impairment of intangible assets	1,798,495	-
Amortization of debt discount and deferred financing costs	1,222,289	246,807
Employee share-based compensation expense	1,432,627	1,032,261
Other share-based compensation expense	323,042	285,154
Change in fair value of earn-out liability	1,320,000	-
Increase (decrease) in cash resulting from changes in (net of effects of acquisition):		
Accounts receivable	(4,278,205)	(818,102)
Inventory	(1,089,733)	(150,479)
Prepaid expenses and other current assets	(382,051)	(161,010)
Other assets	19,213	(48,174)
Accounts payable and accrued expenses	1,446,864	833,013
Accrued interest	312,775	65,281
Other liabilities	(1,408)	(9,825)
Net cash flows from operating activities	(2,461,113)	(5,009,083)
Cash flows from investing activities:		
Purchases of equipment	(401,864)	(417,900)
Cash paid for acquisition, net of cash acquired of \$33,583	-	(466,417)
Net cash flows from investing activities	(401,864)	(884,317)
Cash flows from financing activities:		
Proceeds from exercise of warrants	5,925,539	-
Proceeds from exercise of stock options	885,034	295,753
Repayment of convertible debt related to acquisition	(427,126)	-
Repayment of equipment lease	(11,002)	-
Repurchase of warrants	(568)	-
Proceeds from line of credit with related party	-	1,300,000
Repayment of line of credit	-	(99,000)
Repayment of note payable	-	(50,671)
Proceeds from sale of common stock and warrants and common stock with registration rights, net	-	3,743,588
Net cash flows from financing activities	6,371,877	5,189,670
Net change in cash	3,508,900	(703,730)
Cash, beginning of period	4,112,326	1,340,922

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Cash, end of period	\$ 7,621,226	\$ 637,192
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 8,738	\$ 4,842
Cash paid for income taxes	\$ -	\$ -

See notes to condensed consolidated financial statements.

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Supplemental disclosure of non-cash financing and investing activities:

During the nine months ended September 30, 2012:

- * the Company issued 167,086 shares of stock valued at \$184,653 for accrued Director's fees
- * the Company issued 167,183 shares of stock for cashless exercise of warrants
- * the Company recognized \$9,537 in deferred financing costs related to placement agent warrants issued in conjunction with the convertible Senior Promissory Notes
- * the Company recognized a beneficial conversion feature valued at \$514,456 related to the vested contingent warrants on the line of credit with related party
- * the Company issued 2,632,576 shares of stock valued at \$3,185,223 for payment of the 2011 Earn-out liability related to its acquisition of Surgical Biologics
- * the Company acquired equipment under a capital lease in the amount of \$83,016
- * the Company issued 893,267 shares of stock valued at \$893,267 for payment of the Convertible Secured Promissory Notes related to the acquisition of Surgical Biologics

During the nine months ended September 30, 2011:

- * the Company converted its outstanding convertible debt and accrued interest to equity by issuing 406,664 shares of common stock
- * the Company issued 5,250,000 shares of stock valued at \$7,087,500 in conjunction with its acquisition of Surgical Biologics, LLC
- * the Company recognized a beneficial conversion feature valued at \$437,500 related to the convertible debt of \$1,250,000 issued with regard to its acquisition of Surgical Biologics
- * the Company recognized a beneficial conversion feature valued at \$80,000 related to the convertible Line of Credit with a related party

See notes to condensed consolidated financial statements.

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MIMEDX GROUP, INC.
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Changes to GAAP are established by the Financial Accounting Standards Board (“FASB”) in the form of accounting standards updates (“ASU’s”) to the FASB’s Accounting Standards Codification (“ASC”). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included. Operating results for the three and nine months ended September 30, 2012 and 2011, are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2011, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

You should read these condensed consolidated financial statements together with the historical consolidated financial statements of the Company for the year ended December 31, 2011 included in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission (“SEC”) on March 30, 2012, as amended by Amendment No. 1 filed on April 27, 2012, and by Amendment No. 2 filed on June 21, 2012.

The Company operates in one business segment, Biomaterials, which includes the design, manufacture, and marketing of products and amnion tissue processing for a variety of surgical applications using the Company’s proprietary biomaterials—CollaFix™, HydroFix®, EpiFix® and AmnioFix®.

2. Significant accounting policies

Please see Note 2 to our Consolidated Financial Statements included in the Company’s Form 10-K for the fiscal year ended December 31, 2011, for a description of all significant accounting policies.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform to the current year financial statement presentation.

Use of estimates

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

Accounts Receivable

Accounts receivable represent amounts due from customers for which revenue has been recognized. Generally, the Company does not require collateral or any other security to support its receivables.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing receivables. The Company determines the allowance based on factors such as historical collection experience, customer's current creditworthiness, customer concentration, age of accounts receivable balance and general economic conditions that may affect the customer's ability to pay. The Company has \$116,000 and \$20,000 in the allowance for doubtful accounts as of September 30, 2012 and December 31, 2011, respectively. Actual customer collections could differ from estimates. The approximate provision during the nine months ended September 30, 2012 was \$119,000, and there were approximately \$23,000 of write-offs during the same period.

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Inventories

Inventories are valued at the lower of actual cost or market, using the first-in, first-out (“FIFO”) method. Work in process is calculated by estimating the number of units that will be successfully converted to finished goods, based upon a build-up in the stage of completion using estimated labor inputs for each stage and historical yields reduced by estimated usage for quality control testing. Idle facility expense, excessive spoilage, extra freight, and handling costs are expensed, as necessary, in cost of products sold and are not capitalized into inventories. Allocation of fixed production overheads is based on the normal capacity of production facilities.

Goodwill and intangible assets

Goodwill and intangible assets are tested at least annually for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Intangible assets with finite useful lives are amortized into Selling, General and Administrative Expenses in the condensed consolidated statements of operations using the straight-line method over various periods depending upon the specific asset.

Debt Instruments with Detachable Warrants and Beneficial Conversion Features

According to ASC-470 Debt Instruments with Detachable Warrants, proceeds from the sale of debt instruments with stock purchase warrants (detachable call options) shall be allocated to the two elements based upon the relative fair values of the debt instrument without the warrants and of the warrants themselves at the time of issuance. The portion of the proceeds so allocated to the warrants shall be accounted for as paid-in capital. The remainder of the proceeds shall be allocated to the debt instrument portion of the transaction. Also, the embedded beneficial conversion feature present in the convertible instrument shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital.

Revenue Recognition

The Company sells its products primarily through a combination of independent stocking distributors and representatives in the U.S. and independent distributors in international markets. The Company recognizes revenue when title to the goods and risk of loss transfers to customers, provided there are no material remaining performance obligations required of the Company or any matters of customer acceptance. In cases where the Company utilized distributors or ships product directly to the end user, it recognizes revenue upon shipment provided all revenue recognition criteria have been met. A portion of the Company’s revenue is generated from inventory maintained at hospitals or with field representatives. For these products, revenue is recognized at the time the product has been used or implanted. The Company records estimated sales returns, discounts and allowances as a reduction of net sales in the same period revenue is recognized. The Company recorded approximately \$88,000 and \$22,000 for net sales returns provisions for the three months ended September 30, 2012 and 2011, respectively, and there were approximately \$135,000 and \$0 of charges against the provision during the three months ended September 30, 2012 and 2011, respectively. The Company recorded approximately \$233,000 and \$159,000 for net sales returns provisions for the nine months ended September 30, 2012 and 2011, respectively, and there were approximately \$161,000 and \$102,000 of charges against the provision during the nine months ended September 30, 2012 and 2011, respectively.

Fair value of financial instruments

The carrying value of accounts payable and accrued expenses approximate their fair value due to the short-term nature of these liabilities. The fair value of our short term and long term convertible debt approximates \$4,667,000 which represents the face value less the unamortized discount of any beneficial conversion feature plus accrued but unpaid interest at September 30, 2012. The fair value of warrants issued in conjunction with placement fees was

approximately \$9,000 which represents the face value less the unamortized discount of any beneficial conversion feature at September 30, 2012.

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Net loss per share

Basic net loss per common share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is computed using the weighted-average number of common and dilutive common equivalent shares from stock options, warrants and convertible debt using the treasury stock method. For all periods presented, diluted net loss per share is the same as basic net loss per share, as the inclusion of equivalent shares from outstanding common stock options, warrants and convertible debt would be anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net loss	\$ (4,219,372)	\$ (1,765,723)	\$ (6,057,092)	\$ (7,616,791)
Denominator for basic earnings per share - weighted average shares	84,493,164	73,767,674	84,091,014	72,082,605
Effect of dilutive securities: Stock options and warrants outstanding and convertible debt (a)	—	—	—	—
Denominator for diluted earnings per share - weighted average shares adjusted for dilutive securities	84,493,164	73,767,674	84,091,014	72,082,605
Loss per common share - basic and diluted	\$ (0.05)	\$ (0.02)	\$ (0.07)	\$ (0.11)

(a) Securities outstanding that were excluded from the computation, because they would have been anti-dilutive are as follows:

	September 30, 2012	September 30, 2011
Outstanding Stock Options	12,642,833	10,355,000
Outstanding Warrants	3,241,668	8,096,417
Convertible Debt, promissory notes	5,313,133	—
Convertible Line of Credit with Related Party	1,391,524	1,300,000
Convertible Debt, Acquisition	—	1,250,000
	22,589,158	21,001,417

The table above excludes all securities with contingencies including the earnout liability and contingent warrants.

Recent Accounting Pronouncements

The Company considers the applicability and impact of all ASU's. ASU's not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations.

Goodwill

The FASB issued updated authoritative guidance in September 2011 to amend previous guidance on the annual and interim testing of goodwill for impairment; the guidance became effective for MiMedx at the beginning of its 2012 fiscal year. The guidance provides entities with the option of first assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If it is determined, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would still be required. Annual impairment tests are performed by the Company in the fourth quarter of each year. The adoption of this updated authoritative guidance did not have a significant impact on the Company's consolidated financial statements.

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Fair Value Measurements

The FASB issued updated authoritative guidance in May 2011 to amend fair value measurements and related disclosures; the guidance became effective for MiMedx at the beginning of its 2012 fiscal year. This guidance relates to a major convergence project of the FASB and the International Accounting Standards Board to improve International Financial Reporting Standards (“IFRS”) and GAAP. This guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between IFRS and GAAP. The guidance also changes some fair value measurement principles and enhances disclosure requirements related to activities in Level 3 of the fair value hierarchy. The adoption of this updated authoritative guidance had no impact on the Company’s consolidated financial statements.

Intangibles – Goodwill and Other

In July 2012, the FASB issued an accounting standards update that gives an entity the option to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. This guidance will be effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, which will be the Company’s fiscal year 2013, with early adoption permitted. The Company does not expect the adoption of the guidance will have a material impact on the Company’s consolidated financial statements.

Recently issued accounting pronouncements not yet adopted:

In December 2011, the FASB issued new accounting guidance that will require entities to disclose information about instruments (including derivatives) and transactions eligible for offset in the statement of financial position or subject to an agreement similar to a master netting arrangement. These new provisions are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and should be applied retrospectively for all comparative periods presented. We do not expect this accounting standard to have an impact on our consolidated financial statements.

3. Liquidity and management’s plans

As of September 30, 2012, the Company had approximately \$7,621,000 of cash and cash equivalents. The Company reported total current assets of approximately \$16,140,000 and current liabilities payable in cash of approximately \$5,003,000 after adjusting for the short term earn-out liability payable in MiMedx common stock in the second quarter of 2013. The Company believes that its anticipated cash from operating and financing activities and existing cash and cash equivalents will enable the Company to meet its operational liquidity needs, fund its planned investing activities and pay its debt when due for the next twelve months.

4. Acquisition of Surgical Biologics, LLC

On December 21, 2010, we entered into an Agreement and Plan of Merger (“the Merger Agreement”) with Membrane Products Holdings, LLC and OnRamp Capital Investments, LLC, the owners of Surgical Biologics, LLC (“Surgical Biologics”), a privately held company headquartered in Kennesaw, Georgia. This transaction closed on January 5, 2011 and as a result we acquired all of the outstanding shares of Surgical Biologics in exchange for \$500,000 cash, a total of \$1,250,000 in 4% Convertible Secured Promissory Notes, and \$7,087,500 in stock, represented by 5,250,000 shares of our common stock (525,000 of which were held in escrow for the purpose of securing the indemnification obligations outlined in the Merger Agreement). Contingent consideration shall be payable in a formula determined by sales for the years 2011 and 2012. As presented in the table below, the significant unobservable inputs used in the fair

value measurement of contingent consideration related to the acquisitions are annualized revenue forecasts developed by the Company's management and the probability of achievement of those revenue forecasts. The contingent consideration was initially valued at \$7,404,700 and is shown in the schedule below as fair value of earn-out. We completed the acquisition of Surgical Biologics in an effort to extend our biomaterials product lines. As of December 31, 2011, the Company evaluated the contingent liability based on operating results for the year, and adjusted the earn-out liability to \$7,410,503. On April 30, 2012, the Company issued 2,632,576 shares of its Common Stock valued at \$3,185,223 in payment of the 2011 earn-out. As of September 30, 2012, the Company evaluated the 2012 contingent liability based on operating results for the nine months ended September 30, 2012, and adjusted the 2012 earn-out liability to \$5,545,280.

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Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

		Contingent Liability for Accrued Earn-out Acquisition Consideration
Beginning balance at January 1, 2012	\$	7,410,503
Common stock issued on earn-out		(3,185,223)
Total remeasurement adjustments: (Gains) or losses included in earnings		1,320,000
Ending balance at September 30, 2012	\$	5,545,280

In total, the 4% Convertible Promissory Notes were convertible into up to 1,250,000 shares of the Company's common stock at \$1.00 per share (a) at any time upon the election of the holder of the Convertible Notes; or (b) at the election of the Company, at any such time as the closing price per share of the Company's common stock (as reported by the OTCBB or on any national securities exchange on which the Company's shares may be listed, as the case may be) closes at no less than \$1.75 per share for not less than 20 consecutive trading days in any period prior to the maturity date. When converted, the Common Stock was available to be sold following satisfaction of the applicable conditions as set forth in Rule 144. The 4% Convertible Promissory Notes matured in eighteen (18) months and earned interest at 4% per annum on the outstanding principal amount payable in cash on the maturity date or convertible into shares of common stock of the Company as provided for above. The 4% Convertible Promissory Notes are secured by a security interest in the Intellectual Property, including the Patents and know-how and trade secrets related thereto, owned by, or exclusively licensed to, Surgical Biologics, LLC. In July, 2012, the Company settled the Convertible Promissory Notes by paying approximately \$177,000 in cash and issuing 893,267 shares of MiMedx common stock.

The Company has evaluated the contingent consideration for accounting purposes under GAAP and has determined that the contingent consideration is within the scope of ASC 480 Distinguishing Liabilities from Equity whereby a financial instrument other than an outstanding share, that embodies a conditional obligation that the issuer may settle by issuing a variable number of its equity shares, shall be classified as a liability if, at inception, the monetary value of the obligation is based solely or predominantly on variations in something other than the fair value of the issuer's equity shares.

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The actual purchase price was based on cash paid, the fair value of our stock on the date of the Surgical Biologics acquisition, and direct costs associated with the combination. The actual purchase price was allocated as follows:

Value of 5,250,000 shares issued at \$1.35 per share	\$7,087,500
Cash paid at closing	350,000
Cash retained for working capital	150,000
Assumed Debt	182,777
Convertible Secured Promissory Note	1,250,000
Fair value of earn-out	7,404,700
Total fair value of purchase price	\$16,424,977
Assets purchased:	
Tangible assets:	
Debt-free working capital	\$671,880
Other assets, net	385
Property, plant and equipment	72,866
	745,131
Intangible assets:	
Customer relationships	3,520,000
Supplier relationships	