

Xtant Medical Holdings, Inc.
Form 10-Q
November 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from to

Commission file number: 001-34951

XTANT MEDICAL HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware **20-5313323**
(State or other jurisdiction (I.R.S. Employer
of incorporation or organization) Identification No.)

664 CRUISER LANE

BELGRADE, MONTANA 59714

(Address of principal executive offices) (Zip code)

(406) 388-0480

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

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

- Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

Number of shares of common stock, \$0.000001 par value, of registrant outstanding at November 14, 2018:
13,171,347.

XTANT MEDICAL HOLDINGS, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****XTANT MEDICAL HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except number of shares and par value)

| | As of September 30, 2018 (Unaudited) | As of December 31, 2017 |
|--|---|--|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 5,064 | \$2,856 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$2,108 and \$1,923, respectively | 9,869 | 12,714 |
| Current inventories, net | 22,187 | 22,229 |
| Prepaid and other current assets | 738 | 1,706 |
| Total current assets | 37,858 | 39,505 |
| Non-current inventories, net | - | 194 |
| Property and equipment, net | 8,069 | 9,913 |
| Goodwill | 41,535 | 41,535 |
| Intangible assets, net | 11,248 | 13,826 |
| Other assets | 560 | 732 |
| Total Assets | \$ 99,270 | \$ 105,705 |
| LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Current Liabilities: | | |
| Accounts payable | \$ 5,918 | \$9,316 |
| Accounts payable – related party | - | 160 |
| Accrued liabilities | 3,976 | 15,845 |
| Warrant derivative liability | 48 | 131 |
| Current portion of capital lease obligations | 478 | 366 |
| Total current liabilities | 10,420 | 25,818 |
| Long-term Liabilities: | | |
| Capital lease obligations, less current portion | 251 | 624 |
| Long-term convertible debt, less issuance costs | - | 70,853 |
| Long-term debt, less issuance costs | 75,944 | 67,109 |

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| | | |
|--|------------|------------|
| Total Liabilities | 86,615 | 164,404 |
| Commitments and Contingencies (note 10) | | |
| Stockholders' Equity (Deficit): | | |
| Preferred stock, \$0.000001 par value; 10,000,000 shares authorized; no shares issued and outstanding | - | - |
| Common stock, \$0.000001 par value; 50,000,000 shares authorized; 13,171,347 shares issued and outstanding as of September 30, 2018 and 1,514,899 shares issued and outstanding as of December 31,2017 | - | - |
| Additional paid-in capital | 171,008 | 86,247 |
| Accumulated deficit | (158,353) | (144,946) |
| Total Stockholders' Equity (Deficit) | 12,655 | (58,699) |
| Total Liabilities & Stockholders' Equity (Deficit) | \$ 99,270 | \$ 105,705 |

See notes to unaudited condensed consolidated financial statements.

XTANT MEDICAL HOLDINGS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited, in thousands, except number of shares and per share amounts)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue | | | | |
| Orthopedic product sales | \$17,139 | \$19,618 | \$53,622 | \$62,986 |
| Other revenue | 127 | 171 | 319 | 294 |
| Total Revenue | 17,266 | 19,789 | 53,941 | 63,280 |
| Cost of sales | 5,743 | 8,416 | 17,711 | 23,472 |
| Gross Profit | 11,523 | 11,373 | 36,230 | 39,808 |
| Operating Expenses | | | | |
| General and administrative | 2,505 | 3,330 | 8,931 | 11,985 |
| Sales and marketing | 7,847 | 8,904 | 24,742 | 31,038 |
| Research and development | 347 | 504 | 1,179 | 1,843 |
| Depreciation and amortization | 1,029 | 1,354 | 3,074 | 4,105 |
| Restructuring expenses | 614 | 1,194 | 2,582 | 2,814 |
| Separation related expenses | 436 | 792 | 490 | 1,396 |
| Non-cash compensation expense | 180 | (20) | 585 | 217 |
| Total Operating Expenses | 12,958 | 16,058 | 41,583 | 53,398 |
| Loss from Operations | (1,435) | (4,685) | (5,353) | (13,590) |
| Other (Expense) Income | | | | |
| Interest expense | (1,790) | (3,809) | (8,156) | (10,538) |
| Change in warrant derivative liability | 42 | (20) | 83 | 136 |
| Other (expense) income | 30 | - | 18 | - |
| Total Other (Expense) Income | (1,718) | (3,829) | (8,055) | (10,402) |
| Net Loss from Operations | \$(3,153) | \$(8,514) | \$(13,408) | \$(23,992) |
| Net loss per share: | | | | |
| Basic | \$(0.24) | \$(5.62) | \$(1.19) | \$(15.94) |
| Dilutive | \$(0.24) | \$(5.62) | \$(1.19) | \$(15.94) |
| Shares used in the computation: | | | | |
| Basic | 13,158,326 | 1,514,126 | 11,262,642 | 1,505,493 |
| Dilutive | 13,158,326 | 1,514,126 | 11,262,642 | 1,505,493 |

See notes to unaudited condensed consolidated financial statements.

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XTANT MEDICAL HOLDINGS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited, in thousands)

| | Nine Months Ended September 30, 2018 2017 | |
|---|---|------------|
| Operating activities: | | |
| Net loss | \$(13,408) | \$(23,992) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 4,943 | 7,433 |
| Non-cash interest | 7,853 | 9,966 |
| (Gain) loss on disposal of fixed assets | (15) | 1,909 |
| Non-cash compensation expense/stock option expense | 585 | 593 |
| Provision for losses on accounts receivable and inventory | 298 | 1,711 |
| Change in derivative warrant liability | (83) | (136) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,842 | 4,135 |
| Inventories | (508) | 1,718 |
| Prepaid and other assets | 1,138 | (211) |
| Accounts payable | (3,557) | (3,418) |
| Accrued liabilities | (867) | (897) |
| Net cash used in operating activities | (779) | (1,189) |
| Investing activities: | | |
| Purchases of property and equipment and intangible assets | (308) | (1,456) |
| Proceeds from sale of fixed assets | 251 | - |
| Net cash used in investing activities | (57) | (1,456) |
| Financing activities: | | |
| Proceeds from long-term debt | - | 12,787 |
| Payments on capital leases | (260) | (203) |
| Payments on revolving line credit | - | (10,448) |
| Expenses associated with private placement and convertible debt conversion | (3,507) | - |
| Proceeds from equity private placement | 6,810 | - |
| Proceeds from issuance of stock | 1 | - |
| Net cash provided by financing activities | 3,044 | 2,136 |
| Net change in cash and cash equivalents | 2,208 | (509) |
| Cash and cash equivalents at beginning of period | 2,856 | 2,578 |
| Cash and cash equivalents at end of period | \$5,064 | \$2,069 |

See notes to unaudited condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements

(1) Business Description and Summary of Significant Accounting Policies

Business Description

The accompanying condensed consolidated financial statements include the accounts of Xtant Medical Holdings, Inc. (“Xtant”), a Delaware corporation, and its wholly owned subsidiaries, Xtant Medical, Inc. (“Xtant Medical”), a Delaware corporation, Bacterin International, Inc. (“Bacterin”), a Nevada corporation, and X-Spine Systems, Inc. (“X-spine”), an Ohio corporation (Xtant, Xtant Medical, Bacterin and X-spine are jointly referred to herein as the “Company” or sometimes “we”, “our” or “us”). All intercompany balances and transactions have been eliminated in consolidation.

Xtant is a global medical technology company focused on the design, development, and commercialization of a comprehensive portfolio of orthobiologics and spinal implant systems to facilitate spinal fusion in complex spine, deformity and degenerative procedures.

The accompanying interim condensed consolidated financial statements of Xtant for the three and nine months ended September 30, 2018 and 2017 are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America. They do not include all disclosures required by generally accepted accounting principles for annual consolidated financial statements, but in the opinion of management, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation. Certain reclassifications have been made to prior year financial statements to conform to classifications used in the current year. For the purpose of providing more concise consolidated statements of operations, restructuring expenses, previously included in Other expense (income) in the prior year, were reclassified to Operating Expenses.

Interim results are not necessarily indicative of results which may be achieved in the future for the full year ending December 31, 2018.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto which are included in Xtant’s Annual Report on Form 10-K for the year ended December 31, 2017. The accounting policies set forth in those annual consolidated financial statements are the same as the accounting policies utilized in the preparation of these condensed consolidated financial statements, except as modified for appropriate interim consolidated financial statement presentation.

As described in more detail below, effective as of February 13, 2018, the Company effected a 1-for-12 reverse split of its common stock (the “Reverse Stock Split”). The Reverse Stock Split is reflected in the share amounts in all periods presented in this report.

Corporate Restructuring

Restructuring Agreement

On January 11, 2018, we entered into a Restructuring and Exchange Agreement (the “Restructuring Agreement”) with ROS Acquisition Offshore LP, OrbiMed Royalty Opportunities II, LP (collectively referred to herein as the “Investors”), Bruce Fund, Inc., Park West Partners International, Limited (“PWPI”), Park West Investors Master Fund, Limited (“PWIMF”), and Telemetry Securities, L.L.C., and with the Investors, are collectively referred to herein as the “Holders”.

Pursuant to the Restructuring Agreement, and following the execution of the Sixth Amendment to the 2017 Notes, described in the “Debt” and “Equity” sections below, on January 17, 2018, the Investors converted the 6.00% convertible senior unsecured notes due 2021, plus accrued and unpaid interest, at the \$9.11 per share conversion rate originally provided thereunder (the “2017 Notes”), into 189,645 shares of our common stock.

After giving effect to the Reverse Stock Split (described below), \$70.3 million aggregate principal amount of our then outstanding 6.00% convertible senior unsecured notes due 2021 held by the Holders (the “Remaining Notes”), plus accrued and unpaid interest, were exchanged for newly-issued shares of our common stock at an exchange rate of 138.8889 shares per \$1,000 principal amount of the Remaining Notes, for an exchange price of \$7.20 per share (the “Notes Exchange”). This resulted in the issuance of 10,401,309 shares of our common stock to the Holders and the Investors acquiring an approximately 70% controlling interest in our outstanding shares of common stock. Upon the completion of the Notes Exchange, all outstanding obligations under our convertible senior secured notes were satisfied in full and the Indentures governing such notes were discharged.

Pursuant to the terms of the Restructuring Agreement, we commenced a rights offering to allow our stockholders as of April 27, 2018 record date to purchase up to an aggregate of 1,137,515 shares of our common stock at a subscription price of \$7.20 per share. The rights offering expired on June 18, 2018. We issued 129 shares of common stock in the rights offering and received \$0.9 thousand gross proceeds.

Amended and Restated Certificate of Incorporation

On February 13, 2018, following a special meeting of our stockholders, we filed with the Secretary of State of the State of Delaware a Certificate of Amendment to our Certificate of Incorporation (the “Certificate Amendment”). The Certificate Amendment amended and restated our Certificate of Incorporation (the “Charter”) to, among other things:

effect the Reverse Stock Split;

after giving effect to the Reverse Stock Split, decrease the number of authorized shares of common stock available for issuance from 95,000,000 to 50,000,000 and increase the number of authorized shares of preferred stock available for issuance from 5,000,000 to 10,000,000;

authorize the Board of Directors (“Board”) to increase or decrease the number of shares of any series of our capital stock, provided that such increase or decrease does not exceed the number of authorized shares or be less than the number of shares then outstanding;

authorize the Board to issue new series of preferred stock without approval of the holders of common stock or other series of preferred stock, with such powers, preferences and rights as may be determined by the Board;

authorize a majority of the Board to fix the number of our directors;

indemnify the members of the Board to the fullest extent permitted by law;

remove the classification of the Board to require all directors to be elected annually;

provide that special meetings of our stockholders may only be called by the Board, the chairman of the Board or our chief executive officer;

provide that no stockholder will be permitted cumulative voting at any election of directors;

elect not to be governed by Section 203 of the Delaware General Corporation Law (the “DGCL”);

elect the Court of Chancery of the State of Delaware to be the exclusive forum for any derivative action or proceeding brought on our behalf, any action asserting a breach of a fiduciary duty owed by any of our directors, officers or other employees, any action under the DGCL, our Charter or bylaws or any actions governed by the internal affairs doctrine; and

require the vote of at least two-thirds of the voting power of the then outstanding shares of our capital stock to amend or repeal certain provisions of our Charter.

The Reverse Stock Split became effective as of 5:00 p.m. Eastern Time on February 13, 2018, and our common stock began trading on a split-adjusted basis when the market opened on February 14, 2018. Upon the effectiveness of the Reverse Stock Split, every 12 shares of our issued and outstanding common stock automatically converted into one share of common stock, without any change in the par value per share. In addition, a proportionate adjustment was made to the per share exercise or conversion price and the number of shares issuable upon the exercise of all of our outstanding stock options and convertible securities to purchase shares of common stock and the number of shares underlying restricted stock awards and reserved for issuance pursuant to our equity incentive compensation plan. Any fraction of a share of common stock that would otherwise have resulted from the Reverse Stock Split was rounded down to the nearest whole share. All share and per share amounts have been retroactively restated to reflect the Reverse Stock Split.

Private Placement SPA

On February 14, 2018, we entered into a Securities Purchase Agreement (the “Private Placement SPA”) with the Investors pursuant to which the Investors purchased from us an aggregate of 945,819 shares of our common stock, at a price of \$7.20 per share, for aggregate proceeds of \$6.8 million.

Investor Rights Agreement

Effective February 14, 2018, we entered into an Investor Rights Agreement (the “Investor Rights Agreement”) with the Holders. Under the Investor Rights Agreement, the Investors are permitted to nominate a majority of our directors and designate the chairperson of the Board at subsequent annual meetings, as long as the Investors maintain an ownership threshold in the Company of at least 40% of our then outstanding common stock (the “Ownership Threshold”). If the Investors are unable to maintain the Ownership Threshold, the Investor Rights Agreement contemplates a reduction of nomination rights commensurate with their ownership interests.

For so long as the Ownership Threshold is met, we must obtain the approval of the Investors to proceed with the following actions: (i) issue new securities; (ii) incur over \$0.25 million of debt in a fiscal year; (iii) sell or transfer over \$0.25 million of our assets or businesses or our subsidiaries in a fiscal year; (iv) acquire over \$0.25 million of assets or properties in a fiscal year; (v) make capital expenditures over \$0.125 million individually, or \$1.5 million in the aggregate during a fiscal year; (vi) approve our annual budget; (vii) hire or terminate our chief executive officer; (viii) appoint or remove the chairperson of the Board; and (ix) make, loans to, investments in, or purchase, or permit any subsidiary to purchase, any stock or other securities in another entity in excess of \$0.25 million in a fiscal year. As long as the Ownership Threshold is met, we may not increase the size of the Board beyond seven directors without the approval of a majority of the directors nominated by the Investors.

The Investor Rights Agreement grants the Holders the right to purchase from us a pro rata amount of any new securities that we may propose to issue and sell. The Investor Rights Agreement may be terminated (a) upon the mutual written agreement of all the parties, (b) upon written notice of the Company or an Investor, if such Investor's ownership percentage of our then outstanding common stock is less than 10%, or (c) upon written notice by the Investors. PWPI and PWIMF's right to purchase from us a pro rata amount of any new securities will also terminate at such time as their aggregate ownership percentage of our then outstanding common stock is less than 8.5%.

Registration Rights Agreement

Effective February 14, 2018, we entered into a Registration Rights Agreement (the "Registration Rights Agreement") with the Holders. The Registration Rights Agreement requires us to, among other things, file with the U. S. Securities and Exchange Commission ("SEC") a shelf registration statement within 90 days of the date of the Registration Rights Agreement covering the resale, from time to time, of our common stock issued. This registration statement became effective on June 4, 2018.

Second Amended and Restated Bylaws

On February 14, 2018, we amended and restated our current bylaws by adopting the Second Amended and Restated Bylaws of the Company (the “Amended Bylaws”). The Amended Bylaws amended our existing bylaws to, among other things:

provide for annual and special meetings of stockholders to be held through remote communications;

provide for the election of any directors not elected at an annual meeting of stockholders to be elected at a special meeting of stockholders;

declassify the Board into one group of directors that will hold office until the subsequent annual meeting of stockholders and until the election and qualification of such directors’ respective successors;

provide for the filling of a new directorship or director vacancy by the affirmative vote of the holders of a majority of the voting power of our shares of stock;

allow for a majority of the Board present to adjourn a Board meeting if a quorum is not met;

unless otherwise restricted in the Amended Bylaws or our Charter, provide the Board with the authority to fix the compensation of directors, including without limitation, compensation for services as members of Board committees;

allow us to enter into an agreement with a stockholder to restrict the transfer of shares held by such stockholder in any manner not prohibited by the DGCL; and

allow the Board to declare dividends on our capital stock, subject to any provisions of our Charter and applicable law.

Concentrations and Credit Risk

The Company’s accounts receivables are due from a variety of health care organizations and distributors throughout the world. No single customer accounted for more than 10% of revenue or accounts receivable for the comparable periods. The Company provides for uncollectible amounts when specific credit issues arise. Management’s estimates for uncollectible amounts have been adequate during prior periods, and management believes that all significant credit risks have been identified at September 30, 2018.

Use of Estimates

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the period. Significant estimates include the carrying amount of property and equipment, goodwill, and intangible assets and liabilities; valuation allowances for trade receivables, inventory, and deferred income tax assets and liabilities; valuation of the warrant derivative liability, debt modification, inventory, and estimates for the fair value of stock options grants and other equity awards upon which the Company determines stock-based compensation expense. Actual results could differ from those estimates.

Long-Lived Assets

Long-lived assets, including intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Management reviewed assumptions and tested intangible assets as of September 30, 2018 and determined that no impairment of the carrying value of the long-lived assets existed during the third quarter of 2018.

Goodwill

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have indefinite useful lives are not amortized, instead they are tested for impairment at least annually and whenever events or circumstances indicate the carrying amount of the asset may not be recoverable. In its evaluation of goodwill, the Company performs an assessment of qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired. The results from the assessment and a step 1 analysis allowed the Company to conclude that goodwill was not impaired as of December 31, 2017. The Company conducts its impairment test on an annual basis.

Revenue Recognition

The Company adopted the provisions of Accounting Standards Update (“ASU”) No. 2014-09, Topic 606, *Revenue from Contracts with Customers*, effective January 1, 2018. Given that our revenue recognition has remained generally the same as in prior years, the Company has elected the modified retrospective method of adoption. As of December 31, 2017, we finalized our assessment of the impact of the standard on the consolidated financial statements and determined adoption of Topic 606 was immaterial to our consolidated financial statements and no adjustment was necessary.

The Company’s contracts with its customers are generally reviewed and revised on an annual basis. The Company does not incur upfront costs or exclusivity fees in conjunction with entering into a customer contract. The Company’s customer contracts do not provide for percentage of completion performance measures or contingent consideration. The Company does not have deferred or unearned revenue arrangements with its customers that would give rise to contract liabilities. No contract assets or contract liabilities are recorded in our consolidated balance sheets as of September 30, 2018 or December 31, 2017.

The Company ships to certain customers under consignment arrangements whereby the Company’s product is stored by the customer. The customer is required to report usage of the product to the Company and, upon such notice, the Company invoices the customer and revenue is recognized.

In the normal course of business, the Company accepts returns of product that have not been implanted. Product returns are not material to the Company’s consolidated statements of operations. The Company accounts for shipping and handling activities as a fulfillment cost rather than a separate performance obligation. The Company’s policy is to record revenue net of any applicable sales, use, or excise taxes. Payment terms are generally net 30 days from invoice date and some customers are offered discounts for early pay.

Research and Development

Research and development costs, which are principally related to internal costs for the development of new devices and biologics are expensed as incurred.

Net Loss Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding. Shares issued during the period and shares reacquired during the period are weighted for the portion of the period that they were outstanding. Diluted net income (loss) per share is computed in a manner consistent with that of basic earnings per share while giving effect to all potentially dilutive shares of common stock outstanding during the period, which include the assumed exercise of stock options and warrants using the treasury stock method. Diluted net loss per share was the same as basic net loss per share for the three and nine months ended September 30, 2018 and 2017, as shares issuable upon the exercise of stock options and warrants were anti-dilutive as a result of the net losses incurred for those periods. Dilutive earnings per share are not reported as their effects of including 2,156,882 and 602,607 outstanding stock options and warrants for the three and nine months ended September 30, 2018 and 2017, respectively, are anti-dilutive.

Fair Value of Financial Instruments

The carrying values of financial instruments, including trade accounts receivable, accounts payable, other accrued expenses and long-term debt, approximate their fair values based on terms and related interest rates.

The Company follows a framework for measuring fair value. The framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. As of September 30, 2018, and December 31, 2017, there were no reclassifications in financial assets or liabilities between Level 1, 2 or 3 categories.

The following table sets forth by level, within the fair value hierarchy, our liabilities that are measured at fair value on a recurring basis:

Warrant derivative liability (in thousands):

| As of September | As of December |
|--------------------|-------------------|
|--------------------|-------------------|

| | 30, 2018 | 31, 2017 |
|---------|-------------|-------------|
| Level 1 | - | - |
| Level 2 | - | - |
| Level 3 | \$ 48 | \$ 131 |

The valuation technique used to measure fair value of the warrant liability is based on a lattice valuation model and significant assumptions and inputs determined by us (See Note 9, "Warrants" below).

Level 3 Changes

The following is a reconciliation of the beginning and ending balances for liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine months ended September 30, 2018:

Warrant derivative liability

| | |
|-------------------------------|-------|
| Balance at January 1, 2017 | \$334 |
| Gain recognized in earnings | (203) |
| Balance at January 1, 2018 | \$131 |
| Gain recognized in earnings | (83) |
| Balance at September 30, 2018 | \$48 |

During the nine months ended September 30, 2018, the Company did not change any of the valuation techniques used to measure its liabilities at fair value.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements, with certain practical expedients available. While we are still evaluating the impact of our pending adoption of the new standard on our consolidated financial statements, we expect that upon adoption we will recognize ROU assets and lease liabilities and that the amounts could be material to our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13 *Financial Instruments - Credit losses: Measurement of Credit Losses on Financial Instruments*, which amends certain provisions of ASC 326, *Financial Instruments-Credit Loss*. The ASU changes the impairment model for most financial assets and certain other instruments. For trade and other receivables, held to maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking “expected loss” model that generally will result in the earlier recognition of allowances for losses. The ASU is effective for annual reporting periods beginning after December 15, 2019, including interim periods within those annual periods, and will be applied as a cumulative effect adjustment to retained earnings as of the beginning of the first reporting period for which the guidance is effective. We currently do not expect that the adoption of these provisions will have a material effect on our consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, *Stock Compensation (Topic 718)* which amends the current standard. Specifically, the new standard expands the scope of Topic 718 to include share-based payment awards to non-employees. Additionally, the ASU expands and amends the current standard to include and realign consistent with the changes to revenue standard Topic 606. Management expects that the adoption of this new standard will qualitatively impact the Company’s financial reporting. See further information in the Stock-Based Compensation of the management disclosure section below.

(2) Inventories, Net

Inventories consist of the following (in thousands):

| September | December |
|-----------|----------|
| 30, | 31, |

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| | 2018 | 2017 |
|------------------------------|-----------|-----------|
| Current inventories: | | |
| Raw materials | \$ 3,820 | \$ 4,277 |
| Work in process | 1,087 | 1,515 |
| Finished goods | 24,386 | 23,270 |
| Gross current inventories | 29,293 | 29,062 |
| Reserve for obsolescence | (7,106) | (6,833) |
| Current inventories, net | 22,187 | 22,229 |
| Non-current inventories: | | |
| Finished goods | 765 | 1,072 |
| Reserve for obsolescence | (765) | (878) |
| Non-current inventories, net | - | 194 |
| Total inventories, net | \$ 22,187 | \$ 22,423 |

The Company provides implants and biologic inventory on consignment through its various sales channels to logistically place the inventory near the anticipated surgical location. Consigned inventory was approximately \$9.8 million and \$12.0 million at September 30, 2018 and December 31, 2017, respectively.

(3) Property and Equipment, Net

Property and equipment, net are as follows (in thousands):

| | September 30, 2018 | December 31, 2017 |
|--------------------------------|--------------------------|-------------------------|
| Equipment | \$ 4,157 | \$ 4,471 |
| Computer equipment | 489 | 489 |
| Computer software | 499 | 524 |
| Furniture and fixtures | 164 | 215 |
| Leasehold improvements | 4,022 | 4,030 |
| Vehicles | 10 | 10 |
| Surgical instruments | 11,641 | 11,462 |
| Total cost | 20,982 | 21,201 |
| Less: accumulated depreciation | (12,913) | (11,288) |
| Property and equipment, net | \$ 8,069 | \$ 9,913 |

The Company deploys certain surgical instruments through its various sales channels for use with implant and biologic inventory to be utilized during surgical procedures. The instruments are classified as non-current assets within property and equipment and depreciated using the straight-line method over a five-year useful life.

The net book value of these surgical instruments was approximately \$5.1 million and \$4.6 million at September 30, 2018 and December 31, 2017, respectively. Instruments are recorded at cost and are carried at net book value (cost less accumulated depreciation).

Depreciation expense related to property and equipment, including property under capital lease, for the first nine months of 2018 and 2017 was \$2.4 million and \$3.9 million respectively.

The Company leases certain equipment under capital leases. For financial reporting purposes, minimum lease payments relating to the assets have been capitalized. As of September 30, 2018, the Company has recorded \$1.6 million gross assets in Equipment and \$0.8 million of accumulated depreciation relating to assets under capital leases.

(4) Intangible Assets

The following table sets forth information regarding intangible assets (in thousands):

| | September 30, 2018 | December 31, 2017 |
|----------------------------------|--------------------------|-------------------------|
| Patents | \$ 847 | \$ 847 |
| Acquisition related intangibles: | | |
| Technology | 13,789 | 13,789 |
| Customer relationships | 9,911 | 9,911 |
| Tradename | 1,867 | 1,867 |
| Non-compete | 41 | 41 |
| Accumulated amortization | (15,207) | (12,629) |
| Intangible assets, net | \$ 11,248 | \$ 13,826 |
| Aggregate amortization expense: | \$ 2,578 | \$ 4,629 |

The following is a summary of estimated future amortization expense for intangible assets as of September 30, 2018 (in thousands):

| | |
|-------------------|----------|
| Remainder of 2018 | \$859 |
| 2019 | 3,252 |
| 2020 | 2,170 |
| 2021 | 1,409 |
| 2022 | 1,051 |
| Thereafter | 2,507 |
| Total | \$11,248 |

(5) Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

| | September 30, 2018 | December 31, 2017 |
|----------------------------|-----------------------------------|----------------------------------|
| Accrued stock compensation | \$ 156 | \$ 120 |
| Wages/commissions payable | 2,745 | 2,831 |
| Accrued interest payable | - | 10,835 |
| Other accrued expenses | 1,075 | 2,059 |
| Accrued liabilities | \$ 3,976 | \$ 15,845 |

(6) Debt

Convertible Notes

During the first quarter of 2018 in connection with our Restructuring, all of the outstanding 6.00% convertible senior unsecured notes due 2021 were converted into shares of our common stock and the Indenture governing such notes was discharged.

Twenty-Second Amendment to the Amended and Restated Credit Agreement

Effective January 30, 2018, the Company and Investors entered into the Twenty-Second Amendment to the Amended and Restated Credit Agreement, which amended the Amended and Restated Credit Agreement dated July 27, 2015 by and between Bacterin and ROS Acquisition Offshore LP (collectively, the “Amended and Restated Credit Agreement” and the facility created under such agreement, the “Credit Facility”). This amendment further deferred the Company’s accrued interest payment date for the fiscal quarters ended on December 31, 2016, March 31, 2017, June 30, 2017, September 30, 2017 and December 31, 2017 until February 28, 2018.

Twenty-Third Amendment to the Amended and Restated Credit Agreement

Effective February 14, 2018, the Company and Investors entered into the Twenty-Third Amendment to the Amended and Restated Credit Agreement, which further amended the Amended and Restated Credit Agreement and terms of the Credit Facility. As of this amendment, the interest payable has been carried forward and as modified, the interest rate options within the Credit Facility are as follows: (a) through December 31, 2018, we will have the option at our sole discretion (i) to pay PIK Interest at LIBOR (as defined in the Credit Facility) plus 12% or (ii) pay cash interest at LIBOR plus 10%; (b) beginning January 1, 2019 through June 30, 2019, we will have the option at our sole discretion to either (i) pay PIK Interest at LIBOR plus 15% or (ii) pay cash interest at LIBOR plus 10%; and (c) beginning July 1, 2019 through the maturity date of the Credit Facility, we will pay cash interest at LIBOR plus 10%. The amendment also reduced the prepayment or repayment fee under the Credit Facility to 1%.

This amendment also modified the financial covenants in the Amended and Restated Credit Agreement, including removing the minimum revenue covenant, providing a minimum liquidity covenant, a consolidated leverage ratio covenant, and a minimum consolidated EBITDA covenant, all as defined in the Amended and Restated Credit Agreement. As of September 30, 2018, we were in compliance with all applicable covenants.

Twenty-Fourth Amendment to the Amended and Restated Credit Agreement

On September 17, 2018, the Company and Investors entered into the Twenty-Fourth Amendment to the Amended and Restated Credit Agreement (the “24th Amendment”), which further amended the Amended and Restated Credit Agreement and terms of the Credit Facility, effective as of April 1, 2018. Under the terms of the 24th Amendment, no interest will be charged on the loans under the Credit Facility (the “Loans”) from April 1, 2018 until June 30, 2018.

Due to the interest rate relief provided by the 24th Amendment, the Company performed an assessment of the changes to the terms of the Credit Facility in accordance ASC 470, *Debt*. The Credit Facility was modified based on an evaluation of the present value of cash flows for the old and new debt instruments. Given the modification, a new effective interest rate for the modified loan was calculated based on the carrying amount of the debt and the present value of the revised future cash flows. The modified interest rate is effective through the remaining life of the loan.

Twenty-Fifth Amendment to the Amended and Restated Credit Agreement

Also, on September 17, 2018, the Company and the Investors entered into the Twenty-Fifth Amendment to the Amended and Restated Credit Agreement (the “25th Amendment”), which further amended the Amended and Restated Credit Agreement and terms of the Credit Facility, effective as of August 1, 2018. Under the terms of the 25th Amendment:

no interest will be charged on the Loans under the Credit Facility from July 1, 2018 until December 31, 2018;

the Optional PIK Interest (as such term is defined in the Amended and Restated Credit Agreement) was decreased from 15% plus the LIBO Rate (as such term is defined in the Amended and Restated Credit Agreement) to 10% plus the LIBO Rate, with a 2.3125% floor;

a LIBO Rate floor of 2.3125% was added; and

the fee due upon payment, prepayment or repayment of the principal amount of the Loans under the Credit Facility, whether on the maturity date or otherwise, was increased to 2% from 1% of the aggregate principal amount of such payment, prepayment or repayment.

The Company issued warrants to purchase an aggregate of 1.2 million shares of Company common stock to the Investors, with an exercise price of \$0.01 per share and an expiration date of August 1, 2028 (collectively, the “Warrants”). The issuance of the Warrants occurred on September 17, 2018 and was a condition to the effectiveness of the 25th Amendment. (See Note 9, “Warrants” below).

The Company is required to pay a 2% exit fee at the maturity of the Loans on July 31, 2020.

Long-term debt consists of the following (in thousands):

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------------------|----------------------------------|
| Amounts due under the Credit Facility | \$ 50,673 | \$ 55,787 |
| PIK interest payable related to the Credit Facility | 25,454 | 11,582 |
| 6% convertible senior unsecured notes due 2021 | - | 71,865 |
| Gross long-term debt | 76,127 | 139,234 |
| Less: total debt issuance costs | (183) | (1,272) |
| Long-term debt, less issuance costs | \$ 75,944 | \$ 137,962 |

All gross long-term debt will mature July 31, 2020 and become payable at that time.

(7) Equity

Convertible Note Indenture

During the first quarter of 2018, in connection with our Restructuring (defined above), all of the outstanding 6.00% convertible senior unsecured notes due 2021 were converted or exchanged into shares of our common stock and the Indenture governing such notes was discharged. On January 17, 2018, the Investors converted \$1.6 million aggregate principal amount of 6.00% convertible senior unsecured promissory notes due in 2021, which were issued effective January 17, 2017, plus accrued and unpaid interest, into 189,645 shares of our common stock. On February 14, 2018, an additional \$70.3 million aggregate principal amount of notes, plus accrued and unpaid interest, were exchanged for 10,401,309 newly-issued shares of our common stock.

Private Placement SPA

On February 14, 2018, we sold to the Investors pursuant to the Private Placement SPA 945,819 shares of our common stock, at a price of \$7.20 per share, for aggregate proceeds of \$6.8 million.

Registration Rights Agreement

On May 15, 2018, we filed a shelf resale registration statement with the SEC pursuant to our obligations under the Registration Rights Agreement. This registration statement was declared effective by the SEC on June 4, 2018.

Rights Offering

On May 18, 2018, we distributed to holders of our common stock, at no charge, non-transferable subscription rights to purchase up to an aggregate of 1,137,515 shares of our common stock (the "Rights Offering"). In the Rights Offering, holders received 0.0869816 subscription rights for each share of common stock held on the record date, April 27, 2018. The units were priced at \$7.20 per unit. The Rights Offering expired on June 18, 2018, at which time the rights were no longer exercisable. We issued 129 shares of our common stock in the Rights Offering, resulting in \$0.9 thousand in gross proceeds to us.

(8) Stock-Based Compensation

Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan

On August 1, 2018, our stockholders approved the Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan (the “2018 Plan”) at the 2018 annual meeting of stockholders of Xtant. The 2018 Plan became effective immediately upon approval by our stockholders and will expire on July 31, 2028, unless terminated earlier. The 2018 Plan replaced the Amended and Restated Xtant Medical Equity Incentive Plan (the “Prior Plan”) with respect to future grants of equity awards. The Prior Plan will continue to govern equity awards granted under the Prior Plan. The 2018 Plan permits the Board, or a committee thereof, to grant to eligible employees, non-employee directors and consultants of the Company non-statutory and incentive stock options, stock appreciation rights, restricted stock awards, restricted stock units, deferred stock units, performance awards, non-employee director awards, and other stock-based awards. The Board may select 2018 Plan participants and determine the nature and amount of awards to be granted. Subject to adjustment as provided in the 2018 Plan, the number of shares of our common stock available for issuance under the 2018 Plan is 1,307,747 shares.

After the approval and effectiveness of the 2018 Plan, the Board granted various awards thereunder to certain officers and employees, consisting of stock option grants to purchase an aggregate of 410,770 shares of our common stock and 40,000 shares of restricted stock units. In addition, a restricted stock award for 26,042 shares was granted to one of our non-employee directors.

As of September 30, 2018, of the 1,307,747 shares of common stock available for issuance under the 2018 Plan, 476,812 shares were subject to outstanding awards under the 2018 Plan and 830,935 shares remained available for issuance. Shares of common stock issued under the 2018 Plan may be newly issued shares or reacquired shares. From time to time, we have granted options to purchase shares of our common stock outside of any stockholder-approved plan to new hires (collectively the “Non-Plan Grants”).

Stock options granted under the 2018 Plan may be either incentive stock options to employees, as defined in Section 422A of the Internal Revenue Code of 1986, or non-qualified stock options. The exercise price of all stock options granted under the 2018 Plan must be at least equal to the fair market value of the shares of common stock on the date of the grant. The 2018 Plan is administered by the Board. Stock options granted under the 2018 Plan are generally not transferable, vest in installments over the requisite service period and are exercisable during the stated contractual term of the option only by such optionee.

Stock-based compensation expense recognized in the condensed consolidated statements of operations for the nine months ended September 30, 2018 and 2017 is based on awards expected to vest and reflects an estimate of awards that will be forfeited. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Stock options to purchase an aggregate of 410,770 shares of common stock were issued in the first nine months of 2018; zero options were issued in the comparable period in 2017.

Stock option activity, including options granted under the 2018 Plan, the Prior Plan and the Non-Plan Grants, was as follows (in thousands, except number of shares and per share amounts):

| | 2018 | | | 2017 | | |
|-----------------------------|-----------|---|--|----------|---|--|
| | Shares | Weighted Average Exercise Price Per Share | Weighted Average Fair Value at Grant Date Per Share | Shares | Weighted Average Exercise Price Per Share | Weighted Average Fair Value at Grant Date Per Share |
| Outstanding at January 1 | 67,465 | \$ 71.03 | \$ 36.85 | 100,492 | \$ 62.52 | \$ 33.84 |
| Issued | 410,770 | 5.71 | 3.91 | - | - | - |
| Cancelled or expired | (33,002) | 53.23 | 36.42 | (1,611) | 137.04 | 94.92 |
| Outstanding at September 30 | 445,233 | \$ 12.09 | \$ 6.49 | 98,881 | \$ 61.32 | \$ 33.60 |
| Exercisable at September 30 | 34,463 | \$ 135.23 | \$ 67.26 | 32,335 | \$ 137.04 | \$ 68.04 |

The aggregate intrinsic value of options outstanding as of September 30, 2018 was zero because the closing price of the stock at September 30, 2018 was less than the exercise prices of all options issued under the Prior Plan or the 2018 Plan were fully vested and expensed due to the change of control as a result of the Corporate Restructuring, noted

above.

Total stock-based compensation expense recognized for employees and directors was \$0.6 and \$0.4 million for the nine months ended September 30, 2018 and 2017, respectively and was recognized as Non-cash compensation expense as discussed below.

During the nine months ended September 30, 2018, the Board granted an aggregate of 93,750 shares of restricted stock to our non-employee directors of the Company. These awards will vest and become non-forfeitable with respect to one-half of the underlying shares on February 14, 2019 and the remaining half on February 14, 2020. The total grant date fair value of these restricted stock awards amounts to \$0.4 million in the aggregate or \$4.80 per share and is being recognized ratably over the vesting period. During the nine months ended September 30, 2018, \$0.2 million was expensed as compensation.

On September 15, 2018, the Company issued 40,000 shares at \$6.20 per share of restricted stock to an employee and recognized \$5 thousand of expense in the nine months ended September 30, 2018 associated with this award.

On July 25, 2017, we granted 25,974 shares of restricted stock to certain former non-employee directors of the Company. These awards became fully vested and non-forfeitable on February 13, 2018 as a result of the Restructuring, which constituted a change of control under the Prior Plan. The total expense of these restricted stock awards, which amounted to \$0.2 million in the aggregate or \$9.24 per share, was being recognized over the vesting period as Non-cash compensation expense. During the three months ended March 31, 2018, the remaining \$0.1 million of expense was recognized as non-cash compensation expense.

Effective October 6, 2016, the Board granted our former Chief Executive Officer, an option to purchase 25,000 shares of common stock at an exercise price of \$13.32 per share. This option was granted outside the Prior Plan as an inducement option. As a result of the Restructuring, which constituted a change of control under the option agreement, this option became fully vested on February 13, 2018 and was fully expensed during the quarter ended March 31, 2018. On August 15, 2018, the Board granted our former Chief Executive Officer an additional option to purchase 200,000 shares of common stock at an exercise price of \$6.20 per share, which was scheduled to vest and become exercisable in four equal annual installments, commencing on August 15, 2019. The option to purchase 200,000 shares of common stock terminated as a result of the termination of his employment and his vested options to purchase 25,000 shares of common stock will remain exercisable until January 10, 2019, which is the 90th day after his termination date.

(9) Warrants

The Company issued warrants to purchase an aggregate of 1.2 million shares of Company common stock to the Investors, with an exercise price of \$0.01 per share and an expiration date of August 1, 2028. The issuance of the Warrants occurred on September 17, 2018 and was a condition to the effectiveness of the 25th Amendment. The number of shares of Company common stock issuable upon exercise of the Warrants are subject to standard and customary anti-dilution provisions for stock splits, stock dividends or similar transactions.

The following table summarizes our warrant activities for the nine months ended September 30, 2018:

| | Common Stock Warrants | Weighted Average Exercise Price |
|-----------------------------------|-----------------------------|--|
| Outstanding as of January 1, 2017 | 524,277 | \$ 26.76 |
| Expired | (4,360) | 135.36 |
| Outstanding at January 1, 2018 | 519,917 | \$ 25.68 |
| Issued | 1,200,000 | 0.01 |
| Expired | (8,268) | 72.56 |
| Outstanding at September 30, 2018 | 1,711,649 | \$ 7.46 |

The estimated fair value was derived using a valuation model with the following weighted-average assumptions:

| | Nine Months Ended September 30, 2018 2017 | | | |
|--|---|--|--------|--|
| Value of underlying common stock (per share) | \$3.85 | | \$7.92 | |
| Risk-free interest rate | 2.10% | | 1.85% | |
| Expected term in years | 3.9 | | 4.9 | |
| Volatility | 62 % | | 98 % | |
| Dividend yield | 0 % | | 0 % | |

The following table summarizes our activities related to warrants accounted for as a derivative liability for the nine months ended September 30, 2018 and 2017:

| | 2018 | 2017 |
|-----------------------------|-------------|-------------|
| Balance at January 1, | 93,759 | 93,759 |
| Derivative warrants expired | (6,250) | - |
| Balance at September 30, | 87,509 | 93,759 |

We utilize a lattice valuation model to determine the fair market value of certain warrants accounted for as liabilities. The lattice valuation model accommodates the probability of exercise price adjustment features as outlined in the warrant agreements. We recorded an unrealized gain of \$0.1 million resulting from the change in the fair value of the warrant derivative liability for the first nine months of 2018. Under the terms of some of our warrant agreements, at any time while the warrant is outstanding, the exercise price per share can be reduced to the price per share of future subsequent equity sales of our common stock or a common stock equivalent that is lower than the exercise price per share as stated in the warrant agreement.

(10) Commitments and Contingencies

Operating Leases

We lease six office facilities under non-cancelable operating lease agreements with expiration dates between 2019 and 2025. We have the option to extend the six leases for up to another ten-year term and for one facility, we have the right of first refusal on any sale.

Future minimum payments for the next five years and thereafter as of September 30, 2018, under these leases, are as follows (in thousands):

| | |
|-------------------|---------|
| Remainder of 2018 | \$211 |
| 2019 | 688 |
| 2020 | 396 |
| 2021 | 375 |
| 2022 | 354 |
| Thereafter | 685 |
| Total | \$2,709 |

Rent expense was \$0.9 million and \$0.6 million for the nine months ended September 30, 2018 and 2017, respectively. Rent expense is determined using the straight-line method of the minimum expected rent paid over the term of the agreement. We have no contingent rent agreements.

Capital Leases

Future minimum payments for the next five years and thereafter as of September 30, 2018, under capital leases for equipment, are as follows (in thousands):

| | |
|---|-------|
| Remainder of 2018 | \$133 |
| 2019 | 502 |
| 2020 | 218 |
| 2021 | - |
| 2022 | - |
| Thereafter | - |
| Total minimum lease payments | 853 |
| Less amount representing interest | (124) |
| Present value of obligations under capital leases | 729 |
| Less current portion | (478) |
| Long-term capital lease obligations | \$251 |

Litigation

On August 10, 2017, a civil suit complaint was filed against Xtant in the United States District Court, District of Nevada by Axis Spine NV, LLC (“Axis”), Case No. 2:17-CV-02147-APG-VCF. The complaint alleges breach of contract, breach of the implied covenant of good faith and fair dealing, and tortious interference with prospective economic advantage with respect to an alleged medical device distribution relationship between the parties. Axis seeks relief in the form of damages in an amount in excess of \$1.0 million. The Court is considering Xtant’s motions to dismiss and for summary judgment.

In addition, we are engaged in ordinary routine litigation incidental to our business from time to time, including product liability disputes.

Indemnification Arrangements

Our indemnification arrangements generally include limited warranties and certain provisions for indemnifying customers against liabilities if our products or services infringe a third-party’s intellectual property rights. To date, we have not incurred any material costs as a result of such warranties or indemnification provisions and have not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person’s service as a director or officer, including any action by us, arising out of that person’s services as our director or officer or that person’s services provided to any other company or enterprise at our request.

(11) Income Taxes

In evaluating the realizability of the net deferred tax assets, we take into account a number of factors, primarily relating to the ability to generate taxable income. Where it is determined that it is likely that we will be unable to realize deferred tax assets, a valuation allowance is established against the portion of the deferred tax asset. Because it cannot be accurately determined when or if we will become profitable, a valuation allowance was provided against the entire deferred income tax asset balance.

The Company did not recognize any interest or penalties related to income taxes for the nine months ended September 30, 2018 and 2017. On December 22, 2017, the Tax Cuts and Jobs Act (the “Act”) was signed into legislation. At December 31, 2017, the Company made a reasonable estimate of the effects on the existing deferred tax balances and recorded a provisional amount in the 2017 financial statements.

On December 22, 2017, Staff Accounting Bulletin No. 118 (“SAB 118”) was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Act. In accordance with SAB 118, the Company has provisionally determined that there is no tax deferred tax benefit or expense with respect to the remeasurement of certain deferred tax assets and liabilities due to the full valuation allowance against net deferred tax assets. The Company is still analyzing certain aspects of the Act and refining its calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. There has been no change to the provisional adjustment recorded in 2017 nor during the first nine months of 2018. Additional analysis of the law and the impact to the Company will be performed and any impact will be recorded in the respective period in 2018.

(12) Supplemental Disclosure of Cash Flow Information

Supplemental cash flow information is as follows (in thousands):

| | Nine Months Ended September 30, 2018 2017 | |
|---|---|--------|
| Supplemental disclosure of cash flow information | | |
| <i>Cash paid during the period for:</i> | | |
| Interest | \$ 186 | \$ 386 |
| <i>Non-cash activity:</i> | | |
| Issuance of capital leases | \$ 84 | \$ 967 |
| Interest converted into common stock | \$ 556 | \$ 480 |
| Conversion of convertible debt to equity | \$ 71,865 | \$ - |
| Convertible PIK interest | \$ 4,764 | \$ - |
| Conversion of interest related to the Credit Facility to long-term debt | \$ 7,977 | \$ - |
| Write-off of convertible debt issuance cost | \$ 1,012 | \$ - |
| Debt discount on long-term credit facility | \$ 5,114 | \$ - |
| RSU vesting | \$ 120 | \$ - |
| Transfer of inventory to property and equipment | \$ 448 | \$ - |

(13) Related Party Transactions

The Investors, which collectively own approximately 70% of our outstanding common stock, are the sole holders of our outstanding long-term debt. In addition, as described in more detail under Note (1), we are parties to an Investor Rights Agreement and Registration Rights Agreement with the Investors. Transactions between the Company and the Investors are conducted under the provisions of Amended and Restated Credit Agreement, the Investor Rights Agreement and the Registration Rights Agreement, as noted above.

(14) Segment and Geographic Information

The Company's management reviews financial results and manages the business on an aggregate basis. Therefore, financial results are reported in a single operating segment: the development, manufacture and marketing of orthopedic medical products.

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The Company attributes revenues to geographic areas based on the location of the customer. Approximately 95% and 97% of sales were in the United States, respectively, for the nine months ended September 30, 2018 and 2017. Total revenue by major geographic area is as follows (in thousands):

| | Nine Months Ended September 30, | |
|---------------|---------------------------------------|----------|
| | 2018 | 2017 |
| United States | \$51,288 | \$61,443 |
| Rest of world | 2,653 | 1,837 |
| Total revenue | \$53,941 | \$63,280 |

(15) Subsequent Events

The Board appointed Michael Mainelli as Interim Chief Executive Officer, replacing Carl D. O’Connell, effective October 12, 2018. In connection with Mr. Mainelli’s appointment as an interim officer of the Company, the Company entered into an interim executive employment agreement and stock option award agreement with him the details of which were provided in the Company’s Current Report on Form 8-K filed with the SEC on October 15, 2018.

In connection with Mr. O’Connell’s departure, the Company intends to enter into a standard and customary separation agreement and release with Mr. O’Connell the details of which were also provided in the Company’s Current Report Form 8-K filed with the SEC on October 15, 2018. The Company anticipates separation costs of approximately \$0.6 million.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and accompanying notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as amended by Form 10-K/A. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Some of the numbers included herein have been rounded for the convenience of presentation. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those discussed below in the "Cautionary Statement Regarding Forward-Looking Statements" and elsewhere in this Quarterly Report on Form 10-Q.

Business Overview

We develop, manufacture and market regenerative medicine products and medical devices for domestic and international markets. Our products serve the specialized needs of orthopedic and neurological surgeons, including orthobiologics for the promotion of bone healing, implants and instrumentation for the treatment of spinal disease. We promote our products in the United States largely through independent distributors and stocking agents, augmented by direct employees.

During the first quarter of 2018, we effected a significant restructuring pursuant to which we converted an aggregate of \$71.9 million of aggregate principal amount of debt into equity by issuing an aggregate of 10,590,954 shares of our common stock, in cancellation thereof; issued an additional 945,819 shares of our common stock in a private placement for an aggregate purchase price of \$6.8 million, completed a 1-for-12 reverse split of our common stock after the close of business on February 13, 2018, and replaced our entire Board of Directors. We completed this restructuring during the second quarter of 2018 with a common stock stockholder rights offering, which expired on June 18, 2018 and resulted in the issuance of an additional 129 shares of common stock. Upon completion of this restructuring and as of September 30, 2018, two funds which held a significant portion of our converted indebtedness and continue to hold all of our currently outstanding debt, own approximately 70% of our outstanding common stock. Because of this significant ownership, we are a "controlled company" within the meaning of the NYSE American corporate governance standards.

Results of Operations

Comparison of Quarters Ended September 30, 2018 and September 30, 2017

Revenue

Total revenue for the quarter ended September 30, 2018 was \$17.3 million which represents a decrease of 12.7% compared to revenue of \$19.8 million in the same quarter of the prior year. This decline occurred primarily due to company-initiated discontinued distributor arrangements and challenges in channel management.

Cost of Sales

Cost of sales consists primarily of manufacturing and inventory purchase costs, as well as depreciation of surgical trays. Cost of sales decreased by 31.8%, or \$2.7 million, to \$5.7 million for the quarter ended September 30, 2018 from \$8.4 million for the same quarter of the prior year. This decrease was due primarily to charges of \$2.1 million related to inventory reserves and impairment of surgical instrument asset values in the third quarter of 2017, and the favorable impacts of cost reduction initiatives to fully integrate hardware and biologics operations at the beginning of 2018.

Operating Expenses

Operating expenses include general and administrative expenses, sales and marketing expenses, depreciation, research and development expenses, and compensation costs, including incentive compensation. Operating expenses decreased 19.3%, or \$3.1 million, for the quarter ended September 30, 2018, compared to the quarter ended September 30, 2017. As a percent of total revenue, operating expenses were 75.0% in the quarter ended September 30, 2018 compared to 81.1% in the comparable period in the prior year.

The reduction in operating expenses is primarily attributable to lower commission expense as a result of lower revenue and also Company-initiated discontinued distributor arrangements with high commission rates. In addition, we have continued to execute on our cost reduction initiatives to fully integrate hardware and biologics personnel and operations, which resulted in lower payroll and related expenses, such as benefits and travel costs, and lower overall operating expenses during the quarter ended September 30, 2018 compared to the same prior year period.

General and Administrative

General and administrative expenses consist principally of corporate personnel and related benefits, cash based and stock-based compensation related costs, and corporate expenses for legal, accounting and other professional fees as well as occupancy costs. General and administrative expenses decreased 24.8%, or \$0.8 million, to \$2.5 million for the quarter ended September 30, 2018, compared to the same period of 2017. The decrease is primarily due to a reduction in legal expenses by \$0.5 million, lower utilities and other administrative costs of \$0.2 million, higher inventory absorption of overhead costs during the period of \$0.1 million and lower bad debt expense of \$0.5 million, partially offset by increased payroll expenses of \$0.5 million.

Sales and Marketing

Sales and marketing expenses consist primarily of expenses related to sales and marketing personnel, sales commissions, costs for trade shows, sales conventions and meetings, travel expenses, advertising, and other sales and marketing related costs. Sales and marketing expenses decreased 11.9%, or \$1.1 million, to \$7.8 million for the quarter ended September 30, 2018, compared to \$8.9 million for the same period of 2017. As a percentage of revenue, sales and marketing expenses slightly increased to 45.5% in the third quarter of 2018 from 45.0% in the comparable quarter of the prior year. Commission expenses were reduced \$0.5 million compared to the third quarter of 2017, primarily due to lower sales. In addition, reduced personnel resulted in a decrease of \$0.2 million and travel, trade show, advertisement and other direct marketing expenses decreased \$0.4 million compared to third quarter of 2017.

Research and Development

Research and development expenses consist primarily of internal costs for the development of new technologies and processes for our orthopedic product lines. Research and development expenses decreased \$0.2 million, or 31.2%, from \$0.5 million for the quarter ended September 30, 2017 to \$0.3 million for the same period of 2018. This decrease in research and development expenses was primarily due to a reduction in research and development personnel and related expenses.

Depreciation and Amortization

Depreciation and amortization expense within Operating expenses consists of depreciation and amortization of long-lived assets, respectively, intangible assets, patents, leasehold improvements and equipment. Depreciation and amortization expense declined \$0.3 million to \$1.0 million for the quarter ended September 30, 2018, from \$1.4 million for the same period in 2017.

Restructuring Expenses

Restructuring expenses were \$0.6 million for the quarter ended September 30, 2018 and \$1.2 million for the quarter ended September 30, 2017. Restructuring costs were incurred by the Company related to the recapitalization of the Company and performance improvement measures.

Separation Related Expenses

Separation related expenses were \$0.4 million for the quarter ended September 30, 2018 and \$0.8 million for the quarter ended September 30, 2017. Separation related expenses consist of severance and related benefit expenses for personnel reductions.

Non-cash Compensation Expense

Non-cash compensation expense consists of non-cash expense associated with granting restricted stock to non-employee directors and stock option amortization expense. Non-cash compensation expense for the quarter ended September 30, 2018 increased \$0.2 million from a credit of \$0.2 thousand in the same period of 2017 due to an increased number of unvested stock-based awards outstanding during the current year period.

Interest Expense

Interest expense is related to interest incurred from our debt instruments. Interest expense was \$1.7 million for the quarter ended September 30, 2018, representing a decrease of \$2.1 million over the quarter ended September 30, 2017.

Change in Derivative Liability

For the quarter ended September 30, 2018, we recorded a gain in our non-cash warrant derivative liability of \$0.4 thousand, which was primarily driven by the change in the closing price of our common stock at September 30, 2018. The liability is associated with the issuance of warrants as part of our capital transactions in prior years, which contain certain provisions requiring us to record a change in the fair value of the warrant derivative liability from period to period.

Comparison of Nine Months Ended September 30, 2018 and September 30, 2017

Revenue

Total revenue for the nine months ended September 30, 2018 was \$53.9 million, representing a decrease of 14.8% compared to \$63.3 million in the same period of the prior year. The decrease is primarily attributable to Company-initiated discontinued distributor arrangements and challenges in channel management.

Cost of Sales

Cost of sales consists primarily of manufacturing and inventory purchase costs, as well as depreciation of surgical trays. Cost of sales decreased by 37.1%, or \$5.8 million, to \$17.7 million for the nine months ended September 30, 2018 from \$23.5 million for the nine months ended September 30, 2017. In the first nine months of 2018, the Company did not incur measurable charges related to inventory reserves and impairment of surgical instrument asset values, compared to \$2.3 million in the comparable period of 2017. Cost of sales reductions also occurred in the nine months ended September 30, 2018, compared to the same period in 2017, as a result of cost reduction initiatives to fully integrate hardware and biologics operations at the beginning of 2018. On a comparable basis, as a percent of revenue, Cost of sales is 32.8% for the nine months ended September 30, 2018, compared to 37.1% in the comparable period of 2017.

Operating Expenses

Operating expenses include general and administrative expenses, sales and marketing expenses, depreciation, research and development expenses, and compensation costs, including incentive compensation. Operating expenses decreased \$11.8 million to \$41.6 million for the nine months ended September 30, 2018, compared to \$53.4 million for the nine months ended September 30, 2017. As a percent of total revenue, operating expenses were 77.1% in the nine months ended September 30, 2018 compared to 84.4% in the comparable period in the prior year.

The reduction in operating expenses was primarily attributable to our continued execution on our cost reduction initiatives including consolidation of operating facilities, resulting in lower payroll and related expenses, such as benefits and travel costs, and lower overall operating expenses.

General and Administrative

General and administrative expenses consist principally of corporate personnel and related benefits, cash-based and stock-based compensation related costs, and corporate expenses for legal, accounting and other professional fees as well as occupancy costs. General and administrative expenses decreased 25.2%, or \$3.0 million, to \$9.0 million for the nine months ended September 30, 2018, compared to the same period of 2017. This decrease in general and administrative expenses was primarily due to a reduction in payroll expense and legal fees.

Sales and Marketing

Sales and marketing expenses consist primarily of expenses related to sales and marketing personnel, sales commissions, costs for trade shows, sales conventions and meetings, travel expenses, advertising and other sales and marketing related costs. Sales and marketing expenses decreased 20.3%, or \$6.3 million, to \$24.7 million for the nine months ended September 30, 2018, compared to \$31.0 million for the same period of 2017. As a percentage of revenue, sales and marketing expenses decreased to 45.9% in the nine months of 2018 from 49.0% in the comparable period of the prior year. Changes made to the commission rate structure under certain distribution agreements and lower sales resulted in a reduction of \$4.3 million in commissions, personnel reductions of \$1.0 million and a decline of \$0.5 million of other direct marketing expenses.

Research and Development

Research and development expenses consist primarily of internal costs for the development of new technologies and processes for our orthopedic product lines. Research and development expenses decreased \$0.7 million, or 36.0%, from \$1.8 million for the nine months ended September 30, 2017 to \$1.2 million for the same period of 2018. The decrease in research and development expense is primarily due to reductions in research and development personnel and related expenses.

Depreciation and Amortization

Depreciation and amortization expense within Operating expenses consists of depreciation and amortization of long-lived, respectively, intangible assets, patents, leasehold improvements and equipment. Depreciation and amortization expense declined \$1.0 million to \$3.1 million for the nine months ended September 30, 2018, from \$4.1 million for the same period in 2017.

Restructuring Expenses

Restructuring expenses were \$2.6 million for the nine months ended September 30, 2018 and \$2.8 million for the nine months ended September 30, 2017. Restructuring costs were incurred by the Company related to the recapitalization of the Company and performance improvement measures.

Separation Related Expenses

Separation related expenses were \$0.5 million for the nine months ended September 30, 2018 and \$1.4 million for the nine months ended September 30, 2017. The expense consists of severance and related benefit expenses for personnel reductions, which occurred primarily in the prior year.

Non-cash Compensation Expense

Non-cash compensation expense consists of non-cash expense associated with granting restricted stock to directors and stock option amortization expense. Non-cash compensation expense increased \$0.4 million to \$0.6 million for the nine months ended September 30, 2018, from \$0.2 million for the same period in the prior year primarily as a result of the restructuring change of control in the first quarter of 2018, which triggered the full immediate vesting of outstanding restricted stock and stock options.

Interest Expense

Interest expense is related to interest incurred from our debt instruments. Interest expense was \$8.1 million for the nine months ended September 30, 2018, representing a decrease of \$2.5 million over the nine months ended September 30, 2017. This decrease is due primarily to reduced debt as a result of our Restructuring.

Change in Warrant Derivative Liability

For the nine months ended September 30, 2018, we recorded a gain in our non-cash warrant derivative liability of \$0.1 million, which was primarily driven by the change in the closing price of our common stock at September 30, 2018. The liability is associated with the issuance of warrants as part of our prior capital transactions in prior years which contain certain provisions requiring us to record a change in the fair value of the warrant derivative liability from period to period.

Liquidity and Capital Resources

Since our inception, we have historically financed our operations through operating cash flows and through capital raising transactions to increase leverage and equity. During the first nine months of 2018, we received cash of \$3.3 million through a private placement of equity totaling \$6.8 million, net of \$3.5 million in expenses related to the restructuring transactions that occurred as noted above in Note 1, Corporate Restructuring to our consolidated financial statements. At September 30, 2018, we had \$5.1 million of cash and cash equivalents.

Working capital was \$27.5 million at September 30, 2018 compared to \$13.7 million at December 31, 2017. This increase was due primarily to a reduction in accounts receivable of \$2.8 million, partially offset by a reduction in accounts payable of \$3.4 million and a reduction of \$1.0 million in prepaid and other current assets due to the usage of prepaid restructuring expenses in 2018 attributable to the completion of the corporate restructuring. In addition, the conversion of accrued interest attributable to equity in February 2018, resulted in a reduction of accrued liabilities of \$12 million.

Net cash used in operating activities for the first nine months of 2018 was \$0.9 million compared to \$1.2 million used in operating activities for the comparable period in the prior year. The decrease in cash used in operating activities is primarily attributable to a lower net loss on a cash basis incurred in the first nine months of 2018.

Net cash provided by investing activities for the first nine months of September 30, 2018 was \$0.4 thousands due to the proceeds from sale of fixed assets.

Net cash provided by financing activities was \$3.0 million for the first nine months of 2018 due to the Corporate Restructuring costs and proceeds from the equity issuance in connection therewith, less payments on capital leases.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity or capital expenditures or capital resources.

Cash Requirements

We believe that our September 30, 2018 cash on hand of \$5.1 million and available amended and restated credit agreement capacity of \$2.2 million are sufficient to meet our anticipated cash requirements through December 31, 2019. However, we may require additional funds to fund our future operations and business strategy. Accordingly, there is no assurance that we will not need or seek additional funding prior to such time. We may elect to raise additional funds even before we need them if market conditions for raising additional capital are favorable. We may seek to raise additional funds through various sources, such as equity and debt financings, additional debt restructurings or refinancings, or through strategic collaborations and license agreements. We can give no assurances that we will be able to secure additional sources of funds to support our operations, or if such funds are available to us, that such additional financing will be sufficient to meet our needs or on terms acceptable to us. This is particularly true if economic and market conditions deteriorate.

To the extent that we raise additional capital through the sale of equity or convertible debt securities or the restructuring or refinancing of our debt, the interests of our current stockholders may be diluted, and the terms may include liquidation or other preferences that adversely affect the rights of our current stockholders. If we issue preferred stock, it could affect the rights of our stockholders or reduce the value of our common stock. In particular, specific rights granted to future holders of preferred stock may include voting rights, preferences as to dividends and

liquidation, conversion and redemption rights, sinking fund provisions, and restrictions on our ability to merge with or sell our assets to a third party. Additional debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends. Prior to raising additional equity or debt financing, we must obtain the consent of the Investors, and no assurance can be provided that the Investors would provide such consent, which could limit our ability to raise additional financing.

Cautionary Statement Regarding Forward-Looking Statements

The statements contained in this Form 10-Q that are not purely historical are forward-looking statements within the meaning of applicable securities laws, including the Private Securities Litigation Reform Act of 1995. Our forward-looking statements include, but are not limited to, statements regarding our “expectations,” “hopes,” “beliefs,” “intentions,” or “strategies” regarding the future. In addition, any statements that refer to projections, forecasts, or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. The words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “potential,” “predict,” “project,” “should” and “would,” as well as similar expressions, may identify forward-looking statements but the absence of these words does not mean that a statement is not forward looking. Forward-looking statements in this Form 10-Q may include, for example, statements about:

estimates of our future revenue, expenses and other operating results and capital requirements and liquidity;

the implementation of our business model, strategic plans for our products and technologies; cost reduction and profit improvement initiatives and ability to obtain success with respect to our key initiatives;

our ability to comply with the covenants in our amended and restated credit facility and make all upcoming and deferred interest payments;

our existing cash resources, credit agreement availability, access to additional financing and ability to obtain additional financing in the future or on favorable terms or at all or maintain sufficient liquidity to fund our operations and service our outstanding indebtedness and continue as a going concern; and

the effect of laws, rules, regulations, tax reform, new accounting pronouncements, and outstanding litigation on our business and future performance.

The forward-looking statements contained in this Form 10-Q are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties, or assumptions, many of which are beyond our control, which may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to, those factors described below and in the “Risk Factors” sections of our Annual Report on Form 10-K for the year ended December 31, 2017:

our future revenue and ability to grow or maintain our revenue, especially in light of our current initiative to reduce unprofitable sales channel arrangements;

our future operating losses and ability to achieve or sustain profitability;

our ability to obtain additional financing in the future or on favorable terms or at all or maintain sufficient liquidity to fund our operations and service our outstanding indebtedness;

risks associated with our outstanding indebtedness and our ability to comply with the covenants in our amended and restated credit agreement and make all upcoming and deferred interest payments;

our ability to keep our common stock listed on the NYSE American;

the ability of our sales force to achieve expected results and the effect of our recent change in sales and other management;

our ability to retain and attract new key sales personnel, independent distributors and sales representatives, and other personnel;

our ability to remain competitive;

our ability to innovate, develop and successfully sell new products and market acceptance thereof;

our ability to obtain and maintain regulatory approvals and comply with government regulations;

our ability to obtain government and third-party coverage and reimbursement for our products;

the risk of future product recalls and defects, product liability claims and litigation and inadequate insurance coverage relating thereto;

our ability to obtain and protect our intellectual property and proprietary rights and operate without infringing the intellectual property rights of others;

our ability to obtain donor cadavers for our products and remain accredited with the American Association of Tissue Banks.

our ability to successfully integrate recent and future business combinations or acquisitions and risks involved with such transactions, including potential impairment of goodwill and other intangible assets;

the incurrence of significant expenditures of resources to maintain relatively high levels of instruments and other inventory, which could reduce our cash flows and increase the risk of inventory obsolescence, which could harm our operating results;

our ability to maintain effective internal controls, especially in light of our desire to transition away from our reliance on Aurora Management Partners Inc.;

our ability to deduct all or a portion of the interest payments on the notes for U.S. federal income tax purposes;

our ability to use our net operating loss carry-forwards to offset future taxable income;

the effect of new or revised laws, rules and regulations, such as healthcare reform legislation, including the excise tax on U.S. sales of certain medical devices, and its 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 operating results; and

influence by our management and controlling stockholder.

Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as may be required under applicable securities laws.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required to provide the information required by this Item.

Item 4. Controls and Procedures

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2018. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2018.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting, other than our hiring of a new Chief Financial Officer in August 2018.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

On August 10, 2017, a civil suit complaint was filed against Xtant in the United States District Court, District of Nevada by Axis Spine NV, LLC (“Axis”), Case No. 2:17-CV-02147-APG-VCF. The complaint alleges breach of contract, breach of the implied covenant of good faith and fair dealing, and tortious interference with prospective economic advantage with respect to an alleged medical device distribution relationship between the parties. Axis seeks relief in the form of damages in an amount in excess of \$1.0 million. The Court is considering Xtant’s motions to dismiss and for summary judgment.

In addition, we are engaged in ordinary routine litigation incidental to our business from time to time, including product liability disputes.

Item 1A. Risk Factors

As a smaller reporting company, we are not required to provide the information required by this Item.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Subsequent to the recent appointment of Michael Mainelli as the Company's Interim Chief Executive Officer and the third quarter 2018 appointment of Kathie J. Lenzen as Senior Vice President, Finance & Administration and Chief Financial Officer and Kevin Brandt as Senior Vice President and Chief Commercial Officer, various discussions occurred amongst the Company, the Company's lenders under its credit facility and Aurora Management Partners to establish a strategy to transition functions from Aurora to the Company's senior management team. Based on those discussions, Aurora submitted a notice of termination to the Company stating that it was terminating its engagement with the Company, which had been established by that certain letter agreement between the Company and Aurora dated May 7, 2017 and pursuant to which David M. Baker served as Chief Restructuring Officer and his designees as Deputy Restructuring Officers of the Company. The termination was effective as of November 8, 2018; however, Aurora is expected to continue to provide transitional financial support services to the Company during the transition period.

Item 6. Exhibits

The following exhibits are being filed with or furnished with this Quarterly Report on Form 10-Q:

| Exhibit No. | Description |
|-------------|---|
| 3.1 | <u>Certificate of Amendment to Restated Certificate of Incorporation of Xtant Medical Holdings, Inc. (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on February 13, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 3.2 | <u>Second Amended and Restated Bylaws of Xtant Medical Holdings, Inc. (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on February 16, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 4.1 | <u>Warrant, dated as of September 17, 2018, issued by Xtant Medical Holdings, Inc. to ROS Acquisition Offshore LP (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on September 17, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 4.2 | <u>Warrant, dated as of September 17, 2018, issued by Xtant Medical Holdings, Inc. to OrbiMed Royalty Opportunities II, LP (filed as Exhibit 4.2 to the Company's Current Report on Form 8-K filed with the SEC on September 17, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.1 | <u>Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on August 3, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.2 | <u>Form of Employee Stock Option Award Agreement for use with the Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on August 3, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.3 | <u>Form of Employee Restricted Stock Unit Award Agreement for use with the Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on August 3, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.4 | <u>Form of Non-Employee Director Restricted Stock Award Agreement for use with the Xtant Medical Holdings, Inc. 2018 Equity Incentive Plan (filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the SEC on August 3, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.5 | <u>Employment Agreement dated as of August 20, 2018 between Xtant Medical Holdings, Inc. and Kathie J. Lenzen (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on August 20, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.6 | <u>Twenty-Fourth Amendment to Amended and Restated Credit Agreement, effective as of April 1, 2018, by and among Bacterin International, Inc., Xtant Medical Holdings, Inc., X-Spine Systems, Inc., Xtant Medical, Inc., ROS Acquisition Offshore LP and OrbiMed Royalty Opportunities II, LP (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 17, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 10.7 | <u>Twenty-Fifth Amendment to Amended and Restated Credit Agreement, effective as of August 1, 2018, by and among Bacterin International, Inc., Xtant Medical Holdings, Inc., X-Spine Systems, Inc., Xtant Medical, Inc., ROS Acquisition Offshore LP and OrbiMed Royalty Opportunities II, LP (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on September 17, 2018 (SEC File No. 001-34951) and incorporated by reference herein).</u> |
| 31.1* | |

Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2* Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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

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

101 The following materials from Xtant Medical Holdings, Inc.'s Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, (ii) the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017, (iii) the Condensed Consolidated Statements of Comprehensive Loss for the nine months ended September 30, 2018 and 2017, (iv) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017, and (v) Notes to Condensed Consolidated Financial Statements

* Filed herewith

** Furnished herewith

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SIGNATURES

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

XTANT MEDICAL HOLDINGS, INC.

Date: November
14, 2018

By: */s/ Kathie J. Lenzen*

Name: Kathie J. Lenzen

Title: Senior Vice President, Finance & Administration and Chief Financial Officer (principal financial and accounting officer and duly authorized person)

