

Bacterin International Holdings, Inc.  
Form 10-Q  
August 20, 2010

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2010

Commission file number: 333-158426

BACTERIN INTERNATIONAL HOLDINGS, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

20-5313323  
(I.R.S. Employer  
Identification No.)

600 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Number of shares of common stock, \$0.000001 par value, of registrant outstanding at August 13, 2010: 35,558,864

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BACTERIN INTERNATIONAL HOLDINGS, INC  
 QUARTERLY REPORT ON FORM 10-Q  
 FOR THE QUARTER ENDED JUNE 30, 2010

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

BACTERIN INTERNATIONAL HOLDINGS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (unaudited)	December 31, 2009
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 3,127,330	\$ 54,155
Accounts receivable, net of allowance of \$122,949 and \$81,803, respectively	1,948,371	1,314,418
Notes receivable - trade	476,628	270,565
Inventories, net	5,906,590	5,000,713
Prepaid and other current assets	301,082	30,000
	11,760,001	6,669,851
Property and equipment, net	2,984,837	3,248,096
Intangible assets, net	552,641	554,268
Notes receivable - related party	82,255	-
Other assets	13,675	13,675
<b>Total Assets</b>	<b>\$ 15,393,409</b>	<b>\$ 10,485,890</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,522,233	\$ 1,403,950
Accrued liabilities	605,725	463,630
Other current liabilities	65,000	-
Warrant derivative liability	698,111	75,231
Notes payable	839,942	1,126,693
Notes payable to stockholders	161,124	183,461
Current portion of capital lease obligations	53,245	85,071
Convertible notes payable, net of debt discount	1,728,799	820,787
Current portion of long-term debt	1,200,537	1,202,574
	6,874,716	5,361,397
Long-term Liabilities:		
Capital lease obligation, less current portion	8,551	27,074
Long-term debt, less current portion	210,310	412,545
<b>Total Liabilities</b>	<b>7,093,577</b>	<b>5,801,016</b>
Stockholders' Equity		
Preferred stock, \$.000001 par value; 15,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, \$.000001 par value; 135,000,000 shares authorized; 34,434,314 issued and outstanding shares on June 30, 2010 and 28,211,562 issued shares and 28,152,665 outstanding shares on December 31, 2009	34	28

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Additional paid-in capital	29,471,164	22,238,747
Treasury stock, 58,897 shares on December 31, 2009	-	(76,566)
Retained deficit	(21,171,366)	(17,477,335)
Total Stockholders' Equity	8,299,832	4,684,874
Total Liabilities & Stockholders' Equity	\$ 15,393,409	\$ 10,485,890

See notes to unaudited condensed consolidated financial statements.

BACTERIN INTERNATIONAL HOLDINGS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenue</b>				
Tissue sales	\$ 3,185,772	\$ 1,653,663	\$ 5,890,747	\$ 3,638,340
Royalties and other	15,328	67,815	46,786	181,579
<b>Total Revenue</b>	<b>3,201,100</b>	<b>1,721,478</b>	<b>5,937,533</b>	<b>3,819,919</b>
<b>Cost of tissue sales</b>				
	519,082	174,480	1,123,704	658,119
<b>Gross Profit</b>	<b>2,682,018</b>	<b>1,546,998</b>	<b>4,813,829</b>	<b>3,161,800</b>
<b>Operating Expenses</b>				
General and administrative	1,940,807	1,409,694	3,406,945	2,236,956
Sales and marketing	1,683,853	407,319	3,126,570	754,169
Depreciation	151,661	164,680	304,162	328,254
Stock Options Compensation expense	182,833	128,047	276,429	303,839
<b>Total Operating Expenses</b>	<b>3,959,154</b>	<b>2,109,740</b>	<b>7,114,106</b>	<b>3,623,218</b>
<b>Loss from Operations</b>	<b>(1,277,136)</b>	<b>(562,742)</b>	<b>(2,300,277)</b>	<b>(461,418)</b>
<b>Other Income (Expense)</b>				
Interest expense	(782,116)	(105,427)	(1,305,533)	(201,588)
Change in warrant derivative liability	7,719	-	(94,676)	-
Other income	531	431	6,455	11,298
<b>Total Other Income (Expense)</b>	<b>(773,866)</b>	<b>(104,996)</b>	<b>(1,393,754)</b>	<b>(190,290)</b>
<b>Net Loss Before Benefit (Provision) for Income Taxes</b>	<b>(2,051,002)</b>	<b>(667,738)</b>	<b>(3,694,031)</b>	<b>(651,708)</b>
<b>Benefit (Provision) for Income Taxes</b>				
Current	-	-	-	-
Deferred	-	-	-	-
<b>Net Loss</b>	<b>\$ (2,051,002)</b>	<b>\$ (667,738)</b>	<b>\$ (3,694,031)</b>	<b>\$ (651,708)</b>
<b>Net loss per share:</b>				
Basic	\$ (0.07)	\$ (0.03)	\$ (0.13)	\$ (0.03)
<b>Shares used in the computation:</b>				
Basic	28,318,508	26,250,262	28,274,935	25,931,398

See notes to unaudited condensed consolidated financial statements.



BACTERIN INTERNATIONAL HOLDINGS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Six Months Ended June 30,	
	2010	2009
Operating activities:		
Net loss	\$ (3,694,031)	\$ (651,708)
Noncash adjustments:		
Depreciation and amortization	328,464	351,276
Stock/option awards for services	356,427	590,916
Provision for losses on accounts receivable and inventory	51,902	12,000
Non-cash interest expense	586,534	-
Change in derivative warrant liability	94,676	-
Changes in operating assets and liabilities:		
Accounts receivable	(675,099)	(546,663)
Notes receivable	(206,063)	-
Inventories	(916,633)	(864,351)
Accrued interest	-	28,034
Prepaid and other current assets	(271,082)	(43,299)
Accounts payable	118,282	(288,690)
Accrued and other current liabilities	208,160	(474,121)
Net cash (used in) operating activities	(4,018,463)	(1,886,606)
Investing activities:		
Purchases of property and equipment	(40,903)	(59,507)
Notes receivable from stockholder	(82,255)	(37,569)
Intangible asset additions	(22,675)	(46,917)
Net cash (used in) investing activities	(145,833)	(143,993)
Financing activities:		
Payments on long-term debt	(204,272)	(196,669)
Proceeds from issuance of convertible debt	4,700,000	-
Payments on convertible debt	(340,000)	-
Payments on notes payable	(234,347)	(615,000)
Payments on related party notes	(23,402)	-
Payments on capital leases	(50,349)	(109,499)
Proceeds from issuance of common stock	3,522,348	2,165,002
Purchase of treasury stock	(132,507)	(76,566)
Net cash provided by financing activities	7,237,471	1,167,268
Net change in cash and cash equivalents	3,073,175	(863,331)
Cash and cash equivalents at beginning of period	54,155	1,238,895
Cash and cash equivalents at end of period	\$ 3,127,330	\$ 375,564

See notes to unaudited condensed consolidated financial statements.





Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(1) Business Description and Summary of Significant Accounting Policies

Business Description

Bacterin International Holdings, Inc. (“the “Company” or “Bacterin”) develops, manufactures and markets biologics products to domestic and international markets. Bacterin’s proprietary methods optimize the growth factors in human allografts to create the ideal stem cell scaffold and promote bone and other tissue growth. These products are used in a variety of applications including enhancing fusion in spine surgery, relief of back pain with a facet joint stabilization, promotion of bone growth in foot and ankle surgery, promotion of skull healing following neurosurgery and cartilage regeneration in knee and other joint surgeries.

Bacterin’s device division develops anti-microbial coatings to inhibit infection based upon proprietary knowledge of the phenotypical changes made by microbes as they sense and adapt to changes in their environment. Bacterin develops, employs, and licenses bioactive coatings for various medical device applications. Bacterin’s strategic coating initiatives include the inhibition of biofilm formation, local (as opposed to systemic) drug delivery, local (as opposed to systemic) pain management, and anti-thrombotic factors for medical device applications.

Certain Risks and Concentrations

The Company's revenue is derived principally from the sale or license of its medical products, coatings and device implants. The markets in which the Company competes are highly competitive and rapidly changing. Significant technological advances, changes in customer requirements, or the emergence of competitive products with new capabilities or technologies could adversely affect the Company's operating results. The Company's business could be harmed by a decline in demand for, or in the prices of, its products or as a result of, among other factors, any change in pricing or distribution model, increased price competition, changes in government regulations or a failure by the Company to keep up with technological change. Further, a decline in available tissue donors could have an adverse impact on the business.

Financial instruments subjecting the Company to concentrations of credit risk are accounts and notes receivable. The Company maintains cash, cash equivalents, and short-term investments with various domestic financial institutions. From time to time, the Company's cash balances with its financial institutions may exceed federal deposit insurance limits.

The Company's customers are worldwide with approximately 96% of sales in the United States for the six months ended June 30, 2010. One customer accounted for approximately 11% and 14% of the Company’s revenue for the six months ended June 30, 2010 and 2009, respectively. One customer represented 7% and 14% of accounts receivable at June 30, 2010 and 2009, respectively.

Revenue by geographical region is as follows:

	For the six months ended June 30,	
	2010	2009
United States	\$ 5,714,010	\$ 3,374,529
Rest of World	223,523	445,390
	\$ 5,937,533	\$ 3,819,919



Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(1) Business Description and Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of the 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 financial statements and the reported amounts of revenue and expenses during the period; the carrying amount of property and equipment and intangible assets; valuation allowances for receivables and deferred income tax assets; and estimates of expected term and volatility in determining stock-based compensation expense. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity date of three months or less to be cash equivalents. Cash equivalents are recorded at cost, which approximates market value.

Accounts Receivable and Notes Receivable - Trade

Accounts receivable represents amounts due from customers for which revenue has been recognized. Normal terms on trade accounts receivable are net 30 days and some customers are offered discounts for quick pay. Notes receivable include amounts due from West Coast Tissue Service, a supplier of donors to the Company. The Company performs credit evaluations when considered necessary, but generally does not require collateral to extend credit.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing receivables. The Company determines the allowance based on factors such as historical collection experience, customer's current creditworthiness, customer concentration, age of accounts receivable balance and general economic conditions that may affect a customer's ability to pay. Actual customer collections could differ from estimates. Account balances are charged to the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Provisions to the allowance for doubtful accounts are charged to expense. The Company does not have any off-balance sheet credit exposure related to its customers.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the specific identification method and includes materials, labor and overhead.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets, generally three to seven years for computers and equipment, and 30 years for buildings. Repairs and maintenance are expensed as incurred.

Intangible Assets

Intangible assets include costs to acquire and protect Company patents and are carried at cost less accumulated amortization. The Company amortizes these assets on a straight-line basis over their estimated useful lives of 15 years.

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Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(1) Business Description and Summary of Significant Accounting Policies (continued)

Grants

As part of the Company's efforts to build the development of new technologies, tissue donation and expansion of tissue supply, the Company, may, from time-to-time either provide or receive grants. These grant receipts are used for research and development efforts.

Revenue Recognition

Revenue is recognized when all of the following criteria are met: a) the Company has entered into a legally binding agreement with the customer; b) the products or services have been delivered; c) the Company's fee for providing the products and services is fixed and determinable; and d) collection of the Company's fee is probable.

The Company's policy is to record revenue net of any applicable sales, use, or excise taxes. If an arrangement includes a right of acceptance or a right to cancel, revenue is recognized when acceptance is received or the right to cancel has expired.

The Company sells to certain customers under consignment arrangements whereby the Company ships product to be stored by the customer. The customer is required to report the use to the Company and upon such notice, the Company invoices the customer.

Research and development services revenue is recognized as performed, based on the incurrence of qualifying costs or achievement of milestones as prescribed in the arrangement.

Research and Development

Research and development costs, which are principally related to internal costs for the development of new technologies and processes for tissue and coatings, are expensed as incurred.

Income Taxes

The Company records income taxes under the asset and liability method as prescribed under FASB Accounting Standards Codification ("ASC") 740, Accounting for Income Taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. When applicable, a valuation allowance is established to reduce any deferred tax asset when it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

Impairment of 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. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No impairments of long-lived assets have been identified in any of the periods presented.

Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

## (1) Business Description and Summary of Significant Accounting Policies (continued)

## Net Income (Loss) Per Share

A reconciliation of the denominator used in the calculation of basic and diluted net (loss) per share is as follows:

Net (Loss) Per Share:	June 30,	
	2010	2009
Net (Loss)	\$ (3,694,031)	\$ (651,708)
Basic net loss per share	\$ (0.13)	\$ (0.03)
Weighted average common shares outstanding for basic net (loss) per share	28,274,935	28,931,398

Dilutive earnings per share are not reported as their effects are anti-dilutive.

## Reverse Merger Transaction

On June 30, 2010, the Company completed a reverse merger transaction (the “Reverse Merger”), in which we caused Bacterin International, Inc., a Nevada corporation (“Bacterin”), to be merged with and into a wholly-owned Nevada subsidiary created for purposes of effecting the Reverse Merger, and the stockholders of Bacterin obtained control of the Company. The Reverse Merger was consummated under Nevada corporate law pursuant to an Agreement and Plan of Merger, dated as of June 30, 2010. As a result of the Reverse Merger, Bacterin became our wholly-owned subsidiary and we are now engaged, through Bacterin, in the business of biomaterials research, development, and commercialization.

Pursuant to the terms of the Reverse Merger, the stockholders of Bacterin immediately preceding the Reverse Merger received one share of the Company’s common stock for each two shares of Bacterin common stock such stockholder held prior to the Reverse Merger (effectively resulting in a de facto one-for-two reverse stock split of the then outstanding Bacterin shares). The aggregate number of the Company’s shares of common stock so issued to the Bacterin stockholders, being 28,251,498 shares, represented approximately 96% of our outstanding common stock as of the closing of the Reverse Merger on June 30, 2010, prior to taking into account the issuance of any shares of our common stock pursuant to the private placement described below.

All share amounts, including those for which any securities are exercisable or convertible, have been adjusted to reflect the conversion ratio used in the Reverse Merger. In addition, stockholders equity and earnings per share have been retroactively restated to reflect the number of shares of Company common stock received by Bacterin stockholders in the Reverse Merger or the number of shares of Company common stock receivable by former Bacterin stockholders upon exercise or conversion of other securities held by them, as applicable.

Bacterin was deemed to be the acquiring company for accounting purposes and, accordingly, the Reverse Merger has been accounted for as a recapitalization. The consolidated financial statements of the Company after the Reverse Merger reflect the historical financial results of Bacterin before the consummation of the Reverse Merger and do not include the historical financial results of the Company before the consummation of the Reverse Merger.

## Private Placement



Concurrently with the closing of the Reverse Merger on June 30, 2010, we also completed an initial closing of a private placement to selected qualified investors of shares of our common stock at a purchase price of \$1.60 per share and detachable warrants to purchase one-quarter share of our common stock (at an exercise price of \$2.50 per share) for each share of common stock purchased in the private placement.

In total, we sold 4,934,534 shares of our common stock and warrants to purchase 1,233,634 shares of common stock as part of this initial closing. We received net proceeds of \$7,004,677 in consideration for the sale of the shares of common stock and warrants, which consisted of (i) \$3,522,348 in net cash from investors in the private placement and (ii) \$3,482,329 from note holders in two earlier Bacterin bridge financings (conducted to fund working capital and capital expenditures during the months prior to the Reverse Merger) who converted their outstanding principal and interest into the private placement at a 10% discount to the purchase price, being \$1.44 per share, and received identical warrant coverage as the cash investors except that the exercise price of the converting note holders' warrants is \$2.25 per share, a 10% discount to the exercise price of the warrants received by the cash investors.

Our placement agents in the private placement received an aggregate of \$322,080 in cash fees in connection with the initial closing and reimbursement of their out-of-pocket-expenses. In addition, the placement agents received 67,686 shares of our common stock and warrants to purchase 251,625 shares of our common stock at an exercise price of \$1.60 per share.

The Company still has outstanding from the Bacterin bridge financings approximately \$1,850,000 in principal amount of convertible debt plus interest thereon, which is currently due September, 2010 or upon demand to the note holders who did not convert such debt into the private placement.

#### Stock-Based Compensation

On January 1, 2006, the Company adopted the provisions of ASC 718 for its stock-based compensation plans. Under ASC 718, stock-based compensation costs are recognized based on the estimated fair value at the grant date for all stock-based awards. The Company estimates grant date fair values using the Black-Scholes-Merton option pricing model, which requires assumptions of the life of the award and the stock price volatility over the term of the award. The Company records compensation cost of stock-based awards using the straight line method, which is recorded into earnings over the vesting period of the award. Pursuant to the income tax provisions included in ASC 718-740, the Company has elected the "short cut method" of computing its hypothetical pool of additional paid-in capital that is available to absorb future tax benefit shortfalls.

#### Comprehensive Income (Loss)

Comprehensive loss includes net income or loss, as well as other changes in stockholders' equity that result from transactions and economic events other than those with stockholders. The Company currently does not have any transactions that qualify for accounting and inclusion as other comprehensive income (loss).

#### Fair Value of Financial Instruments

The carrying values of financial instruments, including accounts receivable, notes receivable, accounts payable and other accrued expenses, approximate their fair values.

Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(2) Notes Receivable - Trade

Notes receivable - trade consist of the following:

	June 30, 2010	December 31, 2009
West Coast Tissue Service, Inc.	\$ 476,628	\$ 270,565

West Coast Tissue Service, Inc. is a non-profit corporation organized under Section 501(c)(3) of the Internal Revenue Code. The Company has contracted with West Coast Tissue Service to acquire its donor tissue for use in the Company's production. If the Company were unable to continue to receive donor tissue, it may have a material effect on its financial statements and results of operations. The notes are non-interest bearing.

(3) Inventories

Inventories consist of the following:

	June 30, 2010	December 31, 2009
Raw materials	\$ 1,006,321	\$ 1,279,006
Work in process	1,516,370	1,282,080
Finished goods	3,454,655	2,499,627
	5,977,346	5,060,713
Reserve	(70,756)	(60,000)
	\$ 5,906,590	\$ 5,000,713

(4) Property and Equipment, Net

Property and equipment, net are as follows:

	June 30, 2010	December 31, 2009
Buildings	\$ 1,613,628	\$ 1,613,628
Equipment	2,616,562	2,575,659
Computer equipment	235,566	235,566
Computer software	140,071	140,071
Furniture and fixtures	75,007	75,007
Leasehold improvements	898,248	898,248
Vehicles	68,306	68,306
Total cost	5,647,388	5,606,485
Less: accumulated depreciation	(2,662,551)	(2,358,389)
	\$ 2,984,837	\$ 3,248,096

Maintenance and repairs expense for the six months ended June 30, 2010 and December 31, 2009, was \$39,948 and \$43,328, respectively. Depreciation expense related to property, plant and equipment, including property under

capital lease, for the six months ended June 30, 2010 and 2009 was \$304,162 and \$328,254, respectively.

Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(5) Intangible Assets

Bacterin has been issued various patents with regards to processes for its products.

The following table sets forth information regarding intangible assets:

Intellectual Property	June 30, 2010	December 31, 2009
Gross carrying value	\$ 733,146	\$ 710,471
Accumulated amortization	\$ (180,505)	\$ (156,203)
Net carrying value	\$ 552,641	\$ 554,268
Aggregate amortization expense:	\$ 24,302	\$ 46,080
Estimated amortization expense:		
2010		\$ 47,364
2011		\$ 47,364
2012		\$ 47,364
2013		\$ 47,364
2014		\$ 47,364

(6) Accrued Liabilities

Accrued liabilities consist of the following:

	June 30, 2010	December 31, 2009
Credit cards	\$ -	\$ 10,764
Accrued interest payable	-	75,382
Wages payable	449,034	377,484
Other accrued expenses	156,691	-
	\$ 605,725	\$ 463,630

Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(7) Notes Payable

Notes payable consist of the following:

	June 30, 2010	December 31, 2009
Note payable Kevin Daly	\$ -	\$ 200,000
Note payable Hamilton Group	341,314	426,693
Notes payable Flathead Bank	498,628	500,000
	\$ 839,942	\$ 1,126,693

The note payable to Kevin Daly was a 30-day note payable bearing interest at 15% and was repaid in January 2010. The notes payable to Hamilton Group are notes due under a factoring contract, secured by accounts receivable. The notes payable to Flathead Bank are 6.5% short-term notes with monthly payments of \$3,728 and maturing on June 25, 2010. The maturity date of this note has since been extended until September 25, 2010.

(8) Convertible Notes Payable

	June 30 , 2010	December 31, 2009
12% convertible note payable.	\$ 1,850,000	\$ 890,000
Less: debt discount	(121,201)	(69,213)
	\$ 1,728,799	\$ 820,787

The 12% convertible notes payable, as of June 30, 2010, mature in September, 2010, are secured by the Company's intellectual property and raw material inventory, and are convertible any time into common stock at \$2.00 per share. The Company was in compliance with the restrictive covenants of these notes as of December 31, 2009 and June 30, 2010.

Bacterin International Holdings, Inc.  
Notes to Unaudited Condensed Consolidated Financial Statements

(9) Long-Term Debt

Long-term debt consists of the following:

	June 30, 2010	December 31, 2009
6.5% loan payable to Flathead Bank, \$7,278 monthly payments including interest, maturing September 25, 2010, secured by building	\$ 963,154	\$ 976,218
8.50% loan payable to Flathead Bank, \$9,329 monthly payments, including interest, maturing in 2012, secured by equipment	247,769	293,052
5.00% loan payable to the City of Belgrade, \$3,653 monthly payments, including interest, maturing in 2012, secured by equipment	102,713	141,215
5.00% loan payable to the City of Belgrade, \$6,982 monthly payments, including interest, maturing in 2010, secured by equipment	-	39,044
5.00% loan payable to Valley Bank of Belgrade, \$4,140 monthly payments including interest, maturing September 1, 2011; secured by building	97,211	165,590
	1,410,847	1,615,119
Less: Current portion	(1,200,537)	(1,202,574)
	\$ 210,310	\$ 412,545

The following is a summary of maturities due on the long-term debt as of June 30, 2010:

2010	\$ 1,130,451
2011	140,172
2012	140,224
2013	-
Thereafter	-
Total	\$ 1,410,847

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(10) Capital Leasing Transactions

Future minimum capital and operating lease payments are as follows:

2010	\$ 76,247
2011	28,920
2012	-
Thereafter	-

(11) Notes Payable to Stockholders

Notes payable to stockholders consist of the following:

	June 30, 2010	December 31, 2009
Notes payable to Guy Cook	\$ 76,969	\$ 76,969
Note payable to Mitch Godfrey	84,155	106,492
	\$ 161,124	\$ 183,461

The notes payable to Guy Cook and Mitch Godfrey do not have specified payment terms and bear 6% interest per annum.

(12) Stock-Based Compensation

The Company's Equity Incentive Plan provides for stock awards, including options and performance stock awards, to be granted to employees, consultants, independent contractors, officers and directors. The purpose of the incentive compensation plan is to enable us to attract, retain and motivate key employees, directors and, on occasion, independent consultants, by providing them with stock options and restricted stock grants. Stock options granted under the incentive compensation 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 plan is currently administered by our board of directors but will be administered by our compensation committee once such committee has been established. The administrator of the plan has the power to determine the terms of any stock options granted under the incentive plan, including the exercise price, the number of shares subject to the stock option and conditions of exercise. Stock options granted under the incentive plan are generally not transferable, vest in installments and are exercisable during the lifetime of the optionee only by such optionee. The exercise price of all incentive stock options granted under the incentive plan must be at least equal to the fair market value of the shares of common stock on the date of the grant. The specific terms of each stock option grant will be reflected in a written stock option agreement. At June 30, 2010, the Company had approximately 6 million shares available for issuance under the equity plan.

Compensation expense recognized in the statement of operations for the six months ended June 30, 2010 and 2009 is based on awards ultimately 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.





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## (12) Stock-Based Compensation (continued)

The estimated fair value of stock options granted is done using the Black-Sholes-Merton method applied to individual grants. Key assumptions used to estimate the fair value of stock awards are as follows:

- **Risk-Free Rate:** The risk-free rate is determined by reference to U.S. Treasury yields at or near the time of grant for time periods similar to the expected term of the award.
- **Expected Term:** The Company does not have adequate history to estimate an expected term of stock-based awards, and accordingly, uses the short-cut method as prescribed by Staff Accounting Bulletin 107 to determine an expected term.
- **Volatility:** Since the Company's stock is not publicly-traded, the Company estimates expected volatility based on peer-companies as prescribed by ASC 718.
- **Dividend Yield:** The dividend yield assumption is based on the Company's history and expectation of dividend payouts and was 0% as of June 30, 2010 and 2009.

Activity under the Company's stock option plans was as follows:

	Six months ended June 30, 2010		Six months ended June 30, 2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at Jan. 1,	3,219,356	\$ 1.40	1,919,196	\$ 1.23
Granted	1,082,880	1.67	1,044,000	1.56
Exercised	-	-	-	-
Cancelled or expired	(464,400)	1.56	(108,640)	0.11
Outstanding at June 30,	3,837,836	\$ 1.44	2,854,556	\$ 1.35
Exercisable at June 30,	1,448,352	\$ 1.17	925,037	\$ 0.96

The following table summarizes information concerning non-vested option transactions for the year ended December 31, 2009:

	Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested Options		
Nonvested at January 1, 2009	1,776,044	\$ 0.90
Granted	69,600	1.00
Vested	(55,400)	0.83
Forfeited	(68,400)	