

Bacterin International Holdings, Inc.
Form 10-Q
November 16, 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 September 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 (Do not check if a smaller reporting company) Smaller reporting company

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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

Number of shares of common stock, \$0.000001 par value, of registrant outstanding at November 12, 2010: 35,900,160

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

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PART I – FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
BACTERIN INTERNATIONAL HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2010 (unaudited) | December 31, 2009 |
|--|--------------------------------------|------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 571,844 | \$ 54,155 |
| Accounts receivable, net of allowance of \$ 122,949 and \$81,803, respectively | 2,560,692 | 1,314,418 |
| Notes receivable - trade | 518,905 | 270,565 |
| Inventories, net | 6,971,792 | 5,000,713 |
| Prepaid and other current assets | 221,567 | 30,000 |
| | 10,844,800 | 6,669,851 |
| Property and equipment, net | 3,117,439 | 3,248,096 |
| Intangible assets, net | 541,417 | 554,268 |
| Notes receivable - related party | 82,255 | - |
| Other assets | 15,585 | 13,675 |
| Total Assets | \$ 14,601,496 | \$ 10,485,890 |
| LIABILITIES & STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 1,749,938 | \$ 1,403,950 |
| Accrued liabilities | 1,052,972 | 463,630 |
| Other current liabilities | 315,000 | - |
| Warrant derivative liability | 7,429,968 | 75,231 |
| Notes payable | 956,978 | 1,126,693 |
| Notes payable to stockholders | 162,397 | 183,461 |
| Current portion of capital lease obligations | 35,780 | 85,071 |
| Convertible notes payable, net of debt discount | 393,834 | 820,787 |
| Current portion of long-term debt | 1,097,525 | 1,202,574 |
| Total current liabilities | 13,194,392 | 5,361,397 |
| Long-term Liabilities: | | |
| Capital lease obligation, less current portion | - | 27,074 |
| Long-term debt, less current portion | 292,800 | 412,545 |
| Total Liabilities | 13,487,192 | 5,801,016 |
| 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; 35,903,864 issued shares and 35,900,160 outstanding shares on September 30, 2010 and 28,211,562 issued shares and 28,152,665 outstanding shares on December 31, 2009 | 36 | 28 |
| Additional paid-in capital | 31,329,914 (2,963) | 22,238,747 (76,566) |

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Treasury stock, 58,897 shares on December 31, 2009 and 3,704 shares on September 30, 2010

| | | |
|--|---------------|---------------|
| Retained deficit | (30,212,683) | (17,477,335) |
| Total Stockholders' Equity | 1,114,304 | 4,684,874 |
| Total Liabilities & Stockholders' Equity | \$ 14,601,496 | \$ 10,485,890 |

See notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------------|------------------------------------|----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | | | | |
| Tissue sales | \$ 4,045,347 | \$ 1,356,842 | \$ 9,936,095 | \$ 4,995,682 |
| Royalties and other | 146,639 | 25,975 | 193,424 | 207,554 |
| Total Revenue | 4,191,986 | 1,382,817 | 10,129,519 | 5,203,236 |
| Cost of tissue sales | 711,173 | 973,436 | 1,832,967 | 1,631,555 |
| Gross Profit | 3,480,813 | 409,381 | 8,296,552 | 3,571,681 |
| Operating Expenses | | | | |
| General and administrative | 2,141,028 | 1,468,936 | 5,741,315 | 3,705,892 |
| Sales and marketing | 2,320,446 | 366,827 | 5,465,431 | 1,120,996 |
| Depreciation | 152,994 | 166,964 | 457,156 | 495,218 |
| Stock Options/Restricted stock Compensation expense | 951,442 | 143,121 | 1,227,871 | 446,960 |
| Total Operating Expenses | 5,565,910 | 2,145,848 | 12,891,773 | 5,769,066 |
| Loss from Operations | (2,085,097) | (1,736,467) | (4,595,221) | (2,197,385) |
| Other Income (Expense) | | | | |
| Interest expense | (160,289) | (135,715) | (680,418) | (337,303) |
| Change in warrant derivative liability | (6,731,857) | - | (6,826,533) | - |
| Other income/expense | (65,984) | - | (633,176) | 11,298 |
| Total Other Income (Expense) | (6,958,130) | (135,715) | (8,140,127) | (326,005) |
| Net Loss Before Benefit (Provision) for Income Taxes | (9,043,227) | (1,872,182) | (12,735,348) | (2,523,390) |
| Benefit (Provision) for Income Taxes | | | | |
| Current | - | - | - | - |
| Deferred | - | - | - | - |
| Net Loss | \$ (9,043,227) | \$ (1,872,182) | \$ (12,735,348) | \$ (2,523,390) |
| Net loss per share: | | | | |
| Basic | \$ (0.26) | \$ (0.09) | \$ (0.42) | \$ (0.10) |
| Shares used in the computation: | | | | |
| Basic | 35,398,628 | 21,868,980 | 30,658,229 | 26,247,360 |

See notes to unaudited condensed consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|---------------------------------|----------------|
| | 2010 | 2009 |
| Operating activities: | | |
| Net loss | \$ (12,735,348) | \$ (2,523,390) |
| Noncash adjustments: | | |
| Depreciation and amortization | 493,608 | 529,941 |
| Stock/option awards for services | 427,197 | 686,955 |
| Provision for losses on accounts receivable and inventory | 51,902 | 5,473 |
| Warrants issued for services | - | 13,603 |
| Restricted stock compensation expense | 800,674 | - |
| Non-cash interest expense | 703,942 | - |
| Change in derivative warrant liability | 6,826,533 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,287,420) | (193,383) |
| Notes receivable | (248,340) | - |
| Inventories | (1,981,835) | (570,335) |
| Accrued interest | - | 11,138 |
| Prepaid and other current assets | (191,567) | (61,361) |
| Other assets and liabilities | 313,090 | - |
| Accounts payable | 345,988 | (163,414) |
| Accrued liabilities | 591,680 | 181,128 |
| Net cash (used in) operating activities | (5,889,896) | (2,083,645) |
| Investing activities: | | |
| Purchases of property and equipment | (326,499) | (61,484) |
| Gain on disposal of assets | - | 116,437 |
| Notes receivable from stockholder | (82,255) | (74,702) |
| Intangible asset additions | (23,601) | (55,259) |
| Net cash (used in) investing activities | (432,355) | (75,008) |
| Financing activities: | | |
| Payments on long-term debt | (224,794) | (172,105) |
| Restricted Cash | - | 1,000,000 |
| Proceeds from issuance of convertible debt | 4,700,000 | - |
| Payments on convertible debt | (1,790,000) | - |
| Proceeds from NP shareholders | - | 76,566 |
| Proceeds from notes payable | - | 57,876 |
| Proceeds from capital leases | - | 65,715 |
| Payments on notes payable | (117,511) | (500,000) |
| Payments on related party notes | (23,402) | (34,769) |
| Payments on capital leases | (76,365) | (169,209) |
| Proceeds from issuance of common stock | 5,095,934 | 1,675,000 |
| Purchase of treasury stock | (730,622) | (76,566) |
| Proceeds from the exercise of stock options | 6,700 | - |
| Net cash provided by financing activities | 6,839,940 | 1,922,508 |

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| | | |
|--|------------|-----------|
| Net change in cash and cash equivalents | 517,689 | (236,145) |
| Cash and cash equivalents at beginning of period | 54,155 | 238,895 |
| Cash and cash equivalents at end of period | \$ 571,844 | \$ 2,750 |

See notes to unaudited condensed consolidated financial statements.

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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 97% of sales in the United States for the nine months ended September 30, 2010. One customer accounted for approximately 9% and 14% of the Company’s revenue for the nine months ended September 30, 2010 and 2009, respectively. One customer represented 9% and 12% of accounts receivable at September 30, 2010 and 2009, respectively.

Revenue by geographical region is as follows:

| | For the nine months ended September 30, | |
|---------------|--|--------------|
| | 2010 | 2009 |
| United States | \$ 9,814,424 | \$ 4,703,646 |
| Rest of World | 315,095 | 499,590 |
| | \$ 10,129,519 | \$ 5,203,236 |

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.

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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.

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.

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: | Three Months Ended | |
|---|--------------------|----------------|
| | September 30, | |
| | 2010 | 2009 |
| Net (Loss) | \$ (9,043,227) | \$ (1,872,182) |
| Basic net loss per share | \$ (0.26) | \$ (0.09) |
| Weighted average common shares outstanding for basic net (loss) per share | 35,398,628 | 21,868,980 |

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 28,257,070 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 the initial closing on June 30, 2010, 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 gross proceeds of \$7,508,329 in consideration for the sale of the shares of common stock and warrants, which consisted of (i) \$4,026,000 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.

In the second and final closing of this private placement on July 30, 2010, we sold a total of 1,102,500 additional shares of our common stock together with additional warrants to purchase an aggregate of 275,625 shares of our common stock for total gross cash proceeds of \$1,764,000.

Our placement agents received an aggregate of \$463,200 in cash fees in connection with the private placement (\$322,080 from the initial closing and \$141,120 from the second and final closing) and were reimbursed for their out-of-pocket-expenses. In addition, the placement agents received an aggregate of 106,217 shares of our common stock (84,167 shares from the initial closing and 22,050 shares from the second and final closing) and warrants to purchase 361,875 shares of our common stock (251,625 shares from the initial closing and 110,250 shares from the second and final closing) at an exercise price of \$1.60 per share.

Following the private placement transaction, the Company has permitted an additional \$400,000 in principal amount outstanding under the bridge financing to convert into 280,411 shares of the Company's common stock and warrants to purchase 70,103 shares of the Company's common stock on the same terms as if such debt had actually converted in the private placement transaction.

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.

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(2) Notes Receivable - Trade

Notes receivable - trade consist of the following:

| | September 30, 2010 | December 31, 2009 |
|---------------------------------|-----------------------|----------------------|
| West Coast Tissue Service, Inc. | \$ 518,905 | \$ 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:

| | September 30, 2010 | December 31, 2009 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$ 281,673 | \$ 1,279,006 |
| Work in process | 1,802,197 | 1,282,080 |
| Finished goods | 4,958,678 | 2,499,627 |
| | 7,042,548 | 5,060,713 |
| Reserve | (70,756) | (60,000) |
| | \$ 6,971,792 | \$ 5,000,713 |

(4) Property and Equipment, Net

Property and equipment, net are as follows:

| | September 30, 2010 | December 31, 2009 |
|--------------------------------|-----------------------|----------------------|
| Buildings | \$ 1,613,628 | \$ 1,613,628 |
| Equipment | 2,897,381 | 2,575,659 |
| Computer equipment | 238,243 | 235,566 |
| Computer software | 140,071 | 140,071 |
| Furniture and fixtures | 75,007 | 75,007 |
| Leasehold improvements | 900,348 | 898,248 |
| Vehicles | 68,306 | 68,306 |
| Total cost | 5,932,984 | 5,606,485 |
| Less: accumulated depreciation | (2,815,545) | (2,358,389) |
| | \$ 3,117,439 | \$ 3,248,096 |

Maintenance and repairs expense for the nine months ended September 30, 2010 and December 31, 2009, was \$49,759 and \$43,328, respectively. Depreciation expense related to property, plant and equipment, including property under capital lease, for the nine months ended September 30, 2010 and 2009 was \$457,156 and \$495,218, respectively.

(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 | September 30, 2010 | December 31, 2009 |
|---------------------------------|-----------------------|----------------------|
| Gross carrying value | \$ 734,072 | \$ 710,471 |
| Accumulated amortization | \$ (192,655) | \$ (156,203) |
| Net carrying value | \$ 541,417 | \$ 554,268 |
| Aggregate amortization expense: | \$ 34,724 | \$ 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:

| | September 30, 2010 | December 31, 2009 |
|--------------------------|-----------------------|----------------------|
| Credit cards | \$ - | \$ 10,764 |
| Accrued interest payable | 12,267 | 75,382 |
| Wages payable | 884,040 | 377,484 |
| Other accrued expenses | 156,665 | - |
| | \$ 1,052,972 | \$ 463,630 |

(7) Notes Payable

Notes payable consist of the following:

| | September 30, 2010 | December 31, 2009 |
|-----------------------------|-----------------------|----------------------|
| Note payable Kevin Daly | \$ - | \$ 200,000 |
| Note payable Hamilton Group | 459,661 | 426,693 |
| Notes payable Flathead Bank | 497,317 | 500,000 |
| | \$ 956,978 | \$ 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.

(8) Convertible Notes Payable

| | September 30, 2010 | December 31, 2009 |
|-------------------------------|-----------------------|----------------------|
| 12% convertible note payable. | \$ 400,000 | \$ 890,000 |
| Less: debt discount | (6,165) | (69,213) |
| | \$ 393,834 | \$ 820,787 |

The 12% convertible notes payable, as of September 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 \$1.44 per share. The Company was in compliance with the restrictive covenants of these notes as of September 30, 2010 and December 31, 2009.

(9) Long-Term Debt

Long-term debt consists of the following:

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| 6.5% loan payable to Flathead Bank, \$7,278 monthly payments including interest, note has been extended, 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 | 224,774 | 293,052 |
| 5.00% loan payable to the City of Belgrade, \$3,653 monthly payments, including interest, maturing in 2012, secured by equipment | 102,927 | 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 | 99,470 | 165,590 |
| | 1,390,325 | 1,615,119 |
| Less: Current portion | (1,097,525) | (1,202,574) |
| | \$ 292,800 | \$ 412,545 |

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

| | |
|------------|--------------|
| 2010 | \$ 963,154 |
| 2011 | 99,470 |
| 2012 | 327,701 |
| 2013 | - |
| Thereafter | - |
| Total | \$ 1,390,325 |

(10) Capital Leasing Transactions

Future minimum capital and operating lease payments are as follows:

| | |
|------------|-----------|
| 2010 | \$ 10,411 |
| 2011 | 25,369 |
| 2012 | - |
| Thereafter | - |

(11) Notes Payable to Stockholders

Notes payable to stockholders consist of the following:

| September 30, 2010 | December 31, 2009 |
|-----------------------|----------------------|
|-----------------------|----------------------|

| | | | | |
|-------------------------------|----|---------|----|---------|
| Notes payable to Guy Cook | \$ | 76,969 | \$ | 76,969 |
| Note payable to Mitch Godfrey | | 85,428 | | 106,492 |
| | \$ | 162,397 | \$ | 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 September 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 nine months ended September 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.

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:** 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 September 30, 2010 and 2009.

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

| | Nine months ended September 30, 2010 | | Nine months ended September 30, 2009 | |
|------------------------------|---|--|---|--|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at Jan. 1, | 3,353,493 | \$ 1.33 | 1,999,160 | \$ 1.23 |
| Granted | 1,220,500 | 1.60 | 1,440,000 | 1.56 |
| Exercised | 5,000 | 1.34 | - | - |
| Cancelled or expired | (656,250) | 1.51 | (115,667) | 0.88 |
| Outstanding at September 30, | 3,912,743 | \$ 1.38 | 3,323,493 | \$ 1.33 |
| Exercisable at September 30, | 1,536,198 | \$ 1.13 | 1,033,411 | \$ 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) | 0.90 |
| Nonvested at December 31, 2009 | 1,721,844 | \$ 0.90 |

From time to time the Company may grant stock options to consultants. The Company accounts for consultant stock options in accordance with ASC 505-50. Compensation expense for the grant of stock options to consultants is determined based on the estimated fair value of the stock options at the measurement date as defined in ASC 505-50 and is recognized over the vesting period.

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In connection with private placements of convertible debt, short-term debt, and common stock, the Company issued warrants to purchase shares of common stock at an exercise price of between \$1.16 and \$2.50 per share. During 2009, 38,400 warrants were issued with private placements of common stock, 86,400 warrants were issued with the placement of short-term debt and 105,600 warrants were issued with the placement of convertible notes. Warrants issued with common stock were recorded as additional paid in capital at the estimated fair market value of \$13,601 in 2009. The warrants issued with convertible debt and short-term loans were recorded as interest expense at the estimated fair value of \$137,415 in 2009 using the following assumptions:

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Value of underlying common stock (per share) | \$ 1.60 | \$ 1.60 |
| Risk free rate | Varied | 2.20% |
| Expected term | 2.5 years | 2.5-5 years |
| Dividend yield | 0% | 0% |
| Volatility | 55% | 44-61% |

From January 1, 2010, through September 30, 2010, we issued warrants to purchase 1,482,256 shares of our common stock at an exercise price between \$2.16 and \$2.50 per share in connection with Bacterin's two prior bridge financings and warrants to purchase 1,540,299 shares of our common stock in connection with the closing of our private placement on June 30, 2010 and July 30, 2010 described above. Warrants to purchase 904,688 shares of our common stock which were issued to investors who purchased shares for cash in the private placement have an exercise price of \$2.50 per share and warrants to purchase 635,611 shares of our common stock which were issued to note holders who converted debt they acquired in Bacterin's two prior bridge financings into the private placement have an exercise price of \$2.25 per share, a 10% discount to the exercise price of the investors for cash.

Additionally, we issued warrants to our placement agents to purchase 281,520 shares of our common stock at an exercise price of \$1.66 per share in connection with Bacterin's two prior bridge financings and 361,875 shares of our common stock at an exercise price of \$1.60 per share in connection with the private placements which closed on June 30, 2010 and July 30, 2010.

The following table summarizes our warrant activities for the nine months ended September 30, 2010:

| | Shares | Weighted Average Exercise Price |
|-----------------------------------|-----------|--|
| Outstanding at January 1, 2010 | 3,483,898 | \$ 1.52 |
| Issued | 3,709,464 | 2.20 |
| Exercised | - | - |
| Cancelled or expired | - | - |
| Outstanding at September 30, 2010 | 7,193,362 | 1.87 |

(13) Commitments and Contingencies

Operating Leases

The Company leases office facilities under a non-cancelable operating lease agreement with an expiration date in 2013. The Company has the option to extend the lease for another ten year term and has right of first refusal on any sale. The Company leases additional office facilities under month-to-month arrangements. Future minimum payments for the next five years and thereafter as of September 30, 2010, under these leases, are as follows:

| | |
|------------|------------|
| 2010 | \$ 120,000 |
| 2011 | \$ 120,000 |
| 2012 | \$ 120,000 |
| 2013 | \$ 72,258 |
| Thereafter | \$ - |

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Rent expense was \$109,944 and \$126,716 for the nine months ended September 30, 2010 and 2009, respectively. Rent expense is determined using the straight-line method of the minimum expected rent paid over the term of the agreement. The Company has no contingent rent agreements.

Warranties and Indemnification

The Company's arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third-party's intellectual property rights. To date, the Company has not incurred any material costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in the accompanying financial statements.

The Company has also agreed to indemnify its 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 the Company, arising out of that person's services as the Company's director or officer or that person's services provided to any other company or enterprise at the Company's request.

Litigation

From time to time, the Company is involved in legal proceedings arising in the ordinary course of business. The Company believes that the resolution of these matters will not have a material effect on the Company's financial position, results of operations or liquidity. Legal fees are charged to expense as incurred, unless the probability of incurring a loss is high and the amount can be reasonably estimated, in which case the estimated loss is accrued.

(14) Income Taxes

The components of income (loss) before provision for income taxes consist of the following:

| | Nine Months Ended September 30, | |
|---------------|------------------------------------|----------------|
| | 2010 | 2009 |
| United States | \$ (12,735,348) | \$ (2,523,390) |
| | \$ (12,735,348) | \$ (2,523,390) |

The reconciliation of income tax attributable to operations computed at the U.S. Federal statutory income tax rate of 35% to income tax expense is as follows:

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2010 | 2009 |
| Statutory Federal tax rate | \$ (4,457,371) | \$ (883,361) |
| Valuation allowance | (5,289,594) | 1,049,069 |
| State income taxes, net of Federal benefit | (878,739) | (174,148) |
| Nondeductible meals & entertainment expense | 46,516 | 8,440 |
| | \$ - | \$ - |

(14) Income Taxes (continued)

Deferred tax components are as follows:

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| | September 30, 2010 | December 31, 2009 |
|---------------------------------------|-----------------------|----------------------|
| Deferred tax assets: | | |
| Accrued liability for vacation | \$ 121,008 | \$ 85,734 |
| Accrued commission expense | 249,405 | 48,318 |
| Bad debt reserve | 51,516 | 34,275 |
| Inventory reserve | 29,647 | 25,140 |
| Net operating loss carryovers | 4,757,892 | 3,654,421 |
| Restricted stock compensation expense | 335,482 | - |
| Non-Cash warrant/interest expense | 3,949,109 | 843,321 |
| Debt issuance expense | 1,047,030 | 846,341 |
| Stock compensation | 840,281 | 661,296 |
| Total deferred tax assets | 11,381,370 | 6,198,846 |
| Valuation allowance | (11,317,738) | (6,057,142) |
| Net deferred tax assets | 63,632 | 141,704 |
| Deferred tax liabilities: | | |
| Depreciation | (101,691) | (179,774) |
| Amortization | 38,059 | 38,070 |
| Total deferred tax liabilities | (63,632) | (141,704) |
| Net deferred tax assets | \$ - | \$ - |

The ultimate realization of deferred tax assets is dependent upon the existence or generation of taxable income in the periods when those temporary differences and net operating loss carryovers are deductible. Management considers the scheduled reversal of deferred tax liabilities, taxes paid in carryover years, projected future taxable income, available tax planning strategies, and other factors in making this assessment. Based on available evidence, management does not believe it is more likely than not that all of the deferred tax assets will be realized. Accordingly, the Company has established a valuation allowance equal to the net realizable deferred tax assets. The valuation allowance increased by \$5,260,596 and \$1,704,002 for the nine months ended September 30, 2010 and year ended December 31, 2009, respectively.

At September 30, 2010 and December 31, 2009, the Company had total domestic Federal and state net operating loss carryovers of approximately \$11,355,350 and \$8,652,555, respectively. Federal net operating loss carryovers expire at various dates between 2027 and 2029, while state net operating loss carryovers expire between 2024 and 2029.

Under the Tax Reform Act of 1986, as amended, the amounts of and benefits from net operating loss carryovers and research and development credits may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50%, as defined, over a three year period. The Company does not believe that such an ownership change has occurred in 2010 or 2009.

The 2007 through 2009 tax years remain open to examination by the Internal Revenue Service and the 2005 to 2009 tax years remain open to the Montana Department of Revenue. These taxing authorities have the authority to examine those tax years until the applicable statute of limitations expire.

(15) Employee Benefit Plans

The Company has a SIMPLE IRA retirement plan established for qualified employees. Qualified employees may defer their salary and the deferrals are matched up to 2% for September 30, 2010 and 3% for 2009 of eligible compensation by the Company. The plan covers substantially all full-time employees. Under the terms of the plan, participants may contribute up to the lower of \$10,500 of their salary or the statutorily prescribed limit to the plan. Employees are eligible the first January after their hire date. The Company made matching contributions during the nine months ended September 30, 2010 and 2009 of \$30,953 and \$38,953, respectively.

(16) Supplemental Disclosure of Cash Flow Information

Supplemental cash flow information is as follows:

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2010 | 2009 |
| Supplemental disclosure of cash flow information | | |
| Cash paid during the period for: | | |
| Interest | \$ 364,890 | \$ 199,959 |
| Income taxes | 6,686 | - |
| Non-cash investing and financing activities: | | |
| Acquisition of treasury stock using notes payable | \$ - | \$ 76,566 |
| Conversion of convertible notes payable into common stock | \$ 3,482,324 | \$ 614,992 |

(17) Subsequent Events

The Company has evaluated subsequent events from the balance sheet date through the date of this filing, and determined there are no additional events that require disclosure.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include statements relating to the intended usage and markets for our products and services, the market for our common stock, and our liquidity, results of operations, and ability to meet our anticipated cash requirements. Actual results could differ materially from those currently anticipated as a result of a number of factors, including those set forth under "Risk Factors" in our Current Report on Form 8-K filed with the SEC on July 7, 2010.

You should read the following discussion of our financial condition and results of operations in conjunction with our financial statements and related notes set forth in this report. Unless the context otherwise requires, "we," "our," "us" and similar expressions used in this Management's Discussion and Analysis of Financial Condition and Results of Operation section refer to Bacterin International, Inc., a Nevada corporation ("Bacterin") prior to the closing of the Reverse Merger, as defined below, on June 30, 2010, and Bacterin International Holdings, Inc., f/k/a K-Kitz, Inc., as successor to the business of Bacterin, following the closing of the Reverse Merger transaction.

Background

On June 30, 2010, the Company completed a reverse merger transaction (the "Reverse Merger"), in which we caused 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) with the aggregate number of the Company's shares of common stock so issued to the Bacterin stockholders, being 28,257,070 shares, representing 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.

Before the Reverse Merger, our corporate name was K-Kitz, Inc., and our trading symbol was KKTZ.OB. On June 29, 2010, we changed our corporate name to "Bacterin International Holdings, Inc." which name change became effective for trading purposes on July 1, 2010. Effective July 21, 2010, our trading symbol was changed from KKTZ.OB to BIHI.OB.

Concurrently with the closing of the Reverse Merger, we 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). 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 gross proceeds of \$7,508,329 in consideration for the sale of the shares of common stock and warrants, which consisted of (i) \$4,026,000 in 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.

In the second and final closing of this private placement on July 30, 2010, we sold a total of 1,102,500 additional shares of our common stock together with additional warrants to purchase an aggregate of 275,625 shares of our common stock for total gross cash proceeds of \$1,764,000.

Our placement agents received an aggregate of \$463,200 in cash fees in connection with the private placement (\$322,080 from the initial closing and \$141,120 from the second and final closing) and were reimbursed for their out-of-pocket-expenses. In addition, the placement agents received an aggregate of 106,217 shares of our common stock (84,167 shares from the initial closing and 22,050 shares from the second and final closing) and warrants to purchase 361,875 shares of our common stock (251,625 shares from the initial closing and 110,250 shares from the second and final closing) at an exercise price of \$1.60 per share.

Following the private placement transaction, the Company has permitted an additional \$400,000 in principal amount outstanding under the bridge financing to convert into 280,411 shares of the Company's common stock and warrants to purchase 70,103 shares of the Company's common stock on the same terms as if such debt had actually converted in the private placement transaction.

Concurrently with the closing of the Reverse Merger, the Company repurchased 4,319,404 shares of its common stock from one of its stockholders for aggregate consideration of \$100, as well as certain other good and valuable consideration, and Bacterin repurchased 82,817 shares of its common stock from a few of its stockholders for aggregate consideration of \$132,507. Immediately after these repurchases, all of these shares were cancelled in connection with the Reverse Merger.

Overview

We develop, manufacture and market biologics products to domestic and international markets through our biologics division and are a leader in the field of biomaterials research, device development and commercialization. Our 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.

Our medical devices division develops medical devices intended for use in several diverse clinical areas including orthopedic, plastic, and cardiovascular surgery. Our background and expertise is in the research, testing, and development of coatings for medical devices, particularly antimicrobial-based coatings. Such coatings contain active agents and provide our products with several potential advantages over traditional medical devices. They offer a means of protecting the surface of a medical device from contamination by pathogenic organisms, thereby minimizing the potential for infection. Other coatings can serve as a reserve for local delivery of active agents, enhancing a variety of biological functions such as bone growth and pain management.

The manufacturing and operations of the biologics and device divisions are organized separately while products from both are marketed through several channels including private label arrangements, independent distributors, joint development projects and our direct sales network which we began to implement in the last half of 2009. To date, we have established 13 regions with a regional vice-president in charge of all activities within the region and have hired and trained 52 sales representatives. Our customers are located worldwide, with approximately 97% of our third quarter 2010 sales being derived from customers located in the United States. Our headquarters, laboratory and manufacturing facilities are located in Belgrade, Montana.

Revenue Model

We generate revenue from a variety of sources, including the following: license fees and royalties from collaborative product development efforts with medical device manufacturers; sales from products developed and manufactured by us under our own label; products manufactured by us under private labels for other device distributing companies; and contract revenue from analytical testing and development services provided to medical device manufacturer clients, which tailor our coating process to the client's specific product/medical application. In order for us to recognize

revenue from these sources, the following criteria generally must be met:

- we have entered into a legally binding agreement with the customer for the product or services;
 - the products or services have been delivered by us;
- our fee for providing the products or services is fixed and determinable; and
 - our fee is actually collectible.

We record revenue net of any applicable sales, use, or excise taxes. If our arrangement with the customer includes a right of acceptance or a right to cancel, revenue is recognized when our products or services are accepted or when the right to cancel has expired. We sell to certain customers under consignment arrangements. Under these arrangements, revenue is recorded on the date of sale. Revenue for research and development services provided by us is recognized based upon our meeting certain performance standards, such as incurring qualifying costs, as set forth in the specific arrangement governing the provision of such services.

Results of Operations

Comparison of Three Months Ended September 30, 2010 and 2009

The following table sets forth key components of our results of operations during the three months ended September 30, 2010 and 2009. The acquisition of Bacterin International Holdings, Inc. f/k/a K-Kitz, Inc. by Bacterin through the Reverse Merger was completed June 30, 2010. The combined presentation below refers to that of Bacterin International Holdings, Inc. f/k/a K-Kitz, Inc. and Bacterin.

| | Three Months Ended September 30, | | Increase/ (Decrease) |
|--|-------------------------------------|----------------|-------------------------|
| | 2010 | 2009 | |
| Revenue | | | |
| Tissue sales | \$ 4,045,347 | \$ 1,356,842 | \$ 2,688,505 |
| Royalties and other | 146,639 | 25,975 | 120,664 |
| Total Revenue | 4,191,986 | 1,382,817 | 2,809,169 |
| Cost of tissue sales | 711,173 | 973,436 | (262,263) |
| Gross Profit | 3,480,813 | 409,381 | 3,071,432 |
| Operating Expenses | | | |
| General and administrative | 2,141,028 | 1,468,936 | 672,092 |
| Sales and marketing | 2,320,446 | 366,827 | 1,953,619 |
| Depreciation | 152,994 | 166,964 | (13,970) |
| Stock Options/Restricted stock Compensation expense | 951,442 | 143,121 | 808,321 |
| Total Operating Expenses | 5,565,910 | 2,145,848 | 3,420,062 |
| Loss from Operations | (2,085,097) | (1,736,467) | (348,630) |
| Other Income (Expense) | | | |
| Interest income (expense) | (160,289) | (135,715) | (24,574) |
| Change in warrant derivative liability | (6,731,857) | - | (6,731,857) |
| Other income/expense | (65,984) | - | (65,984) |
| Total Other Income (Expense) | (6,958,130) | (135,715) | (6,822,415) |
| Net Loss Before Benefit (Provision) for Income Taxes | (9,043,227) | (1,872,182) | (7,171,045) |
| Benefit (Provision) for Income Taxes | | | |
| Current | - | - | - |
| Deferred | - | - | - |
| Net Loss | \$ (9,043,227) | \$ (1,872,182) | \$ (7,171,045) |

Revenue

Total revenue for the three months ended September 30, 2010 increased by \$2,809,169, or 203%, to \$4,191,986, compared to \$1,382,817 in the three months ended September 30, 2009. The increase related primarily to the implementation of a direct sales force effort in July 2009. Prior to that time, we utilized a distributor model with a limited direct sales force.

Cost of tissue sales

Costs of revenue consist primarily of tissue and device manufacturing costs. Costs of revenue decreased by 27%, or \$262,263, to \$711,173 for the three months ended September 30, 2010, from \$973,436 for the three months ended September 30, 2009. Cost of revenue decrease was the result of an inventory adjustment of approximately \$669,000 which resulted an increase in cost of tissue sales recorded in the third quarter of 2009 partially offset by the increase in cost of tissue sales resulting from the above noted revenue increases. Our third quarter 2010 gross profit margin of 83% compared to 30% for the three months ended September 30, 2009.

Operating Expenses

Operating expenses include general and administrative expenses, selling and marketing expenses, depreciation, and compensation costs, including incentive compensation and non cash stock based compensation. Operating expenses increased 159%, or \$3,420,062, to \$5,565,910 for the three months ended September 30, 2010 from \$2,145,848 for the three months ended September 30, 2009, primarily due to the reasons set forth below.

General and Administrative

General and administrative expenses consist principally of corporate personnel compensation related costs and corporate expenses for legal, accounting and other professional fees as well as occupancy costs. General and administrative expenses increased 46%, or \$672,092, to \$2,141,028, for the three months ended September 30, 2010 compared to \$1,468,936 for the three months ended September 30, 2009. The increase is largely associated with increased salaries and wages and legal, professional fees and insurance expense associated with being a public company.

Selling and Marketing

Selling and marketing expenses include sales based compensation expense and primarily consist of costs for trade shows, sales conventions and meetings, travel expenses, advertising and other non-personnel sales and marketing related costs. Selling and marketing expenses increased 533%, or \$1,953,619 to \$2,320,446 for the three months ended September 30, 2010 from \$366,827 for the third quarter of 2009. The increases were primarily the result of increased personnel costs associated with the development of a direct sales force. In addition, travel costs associated with the larger sales force and a substantial increase in marketing and advertising activities were incurred in 2010.

Depreciation

Depreciation expense consists of depreciation of long-lived property and equipment. Depreciation expenses decreased 8% to \$152,994 for the three months ended September 30, 2010 from \$166,964 for the three months ended September 30, 2009. This decrease was a result of certain assets becoming fully depreciated.

Stock Options/Restricted Stock Compensation Expense

Stock options compensation expense consists of non-cash based stock compensation expense and non-cash expense associated with granting restricted stock to consultants. Stock options/restricted stock compensation expense increased 565%, or \$808,321, to \$951,442 for the three months ended September 30, 2010 from \$143,121 in the comparable period of the prior year. This increase was primarily due to the granting of restricted shares to consultants during the third quarter of 2010 and an increase in the number of stock options granted to employees.

Interest Expense

Interest expense is from our notes payable and convertible debt instruments. Certain of our notes payable, in addition to accruing interest, had beneficial conversion features, whereby the holder of the note converted the principal and all accrued interest into common stock at a price of \$1.44 per share, a discount of \$.16 per share to the private placement price. Interest expense (income) for the three months ended September 30, 2010 increased 18% to \$160,289, as compared to \$135,715 for the three months ended September 30, 2009.

Change in Warrant Derivative Liability

For the quarter, the Company recorded a non cash charge of \$6,731,857 associated with the issuance of warrants as part of its convertible debt financing, based upon the closing price of the Company's common stock on September 30, 2010.

Comparison of Nine Months Ended September 30, 2010 and September 30, 2009

The following table sets forth key components of our results of operations during the nine months ended September 30, 2010 and 2009. The acquisition of Bacterin International Holdings, Inc. f/k/a K-Kitz, Inc. by Bacterin through the Reverse Merger was completed June 30, 2010. The combined presentation below refers to that of Bacterin International Holdings, Inc. f/k/a K-Kitz, Inc. and Bacterin.

| | Nine Months Ended September 30, | | Increase/ (Decrease) |
|--|---------------------------------------|----------------|-------------------------|
| | 2010 | 2009 | |
| Revenue | | | |
| Tissue sales | \$ 9,936,095 | \$ 4,995,682 | \$ 4,940,413 |
| Royalties and other | 193,424 | 207,554 | (14,130) |
| Total Revenue | 10,129,519 | 5,203,236 | 4,926,283 |
| Cost of tissue sales | 1,832,967 | 1,631,555 | 201,412 |
| Gross Profit | 8,296,552 | 3,571,681 | 4,724,871 |
| Operating Expenses | | | |
| General and administrative | 5,741,315 | 3,705,892 | 2,035,423 |
| Sales and marketing | 5,465,431 | 1,120,996 | 4,344,435 |
| Depreciation | 457,156 | 495,218 | (38,062) |
| Stock Options/Restricted stock Compensation expense | 1,227,871 | 446,960 | 780,911 |
| Total Operating Expenses | 12,891,773 | 5,769,066 | 7,122,707 |
| Loss from Operations | (4,595,221) | (2,197,385) | (2,397,836) |
| Other Income (Expense) | | | |
| Interest income (expense) | (680,418) | (337,303) | (343,115) |
| Change in warrant derivative liability | (6,826,533) | - | (6,826,533) |
| Other income/expense | (633,176) | 11,298 | (644,474) |
| Total Other Income (Expense) | (8,140,127) | (326,005) | (7,814,122) |
| Net Loss Before Benefit (Provision) for Income Taxes | (12,735,348) | (2,523,390) | (10,211,958) |
| Benefit (Provision) for Income Taxes | | | |
| Current | - | - | - |
| Deferred | - | - | - |
| Net Loss | \$ (12,735,348) | \$ (2,523,390) | \$ (10,211,958) |

Revenue

Total revenue for the nine months ended September 30, 2010 increased 95% to \$10,129,519 compared to \$5,203,236 in the comparable prior year period. The increase of \$4,926,283 was largely the result of transitioning the sales model in the second half of 2009 from a distributorship model with a limited direct sales force to a direct sales force model.

Cost of tissue Sales

Costs of revenue consist primarily of tissue and device manufacturing costs. Costs of revenue increased by 12% or \$201,412 to \$1,832,967 from \$1,631,555 for the nine months ended September 30, 2009. Cost of revenue increase was the result of increased costs associated with our higher sales partially offset by an inventory adjustment of \$669,000 recorded in the third quarter of 2009. Our gross profit margin for the nine months ended September 30, 2010 was 82% compared to 69% for the comparable prior year period.

Operating Expenses

Operating expenses include general and administrative expenses, selling and marketing expenses, depreciation, research and development expenses, and compensation costs, including incentive compensation. Operating expenses increased 124%, or \$7,122,707, for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009, primarily due to the reasons set forth below.

General and Administrative

General and administrative expenses consist principally of corporate personnel compensation related costs and corporate expenses for legal, accounting and other professional fees as well as occupancy costs. General and administrative expenses increased 55%, or \$2,035,423, to \$5,741,315, for the nine months ended September 30, 2010 compared to 2009. The increase is largely associated with increased personnel costs as well as legal and professional fees incurred between the two periods.

Selling and Marketing

Selling and marketing expenses include sales based compensation expense and primarily consist of costs for trade shows, sales conventions and meetings, travel expenses, advertising and other sales and marketing related costs. Selling and marketing expenses increased 388%, or \$4,344,435, to \$5,465,431 for the nine months ended September 30, 2010 from \$1,120,996 for the comparable prior year period. As a percentage of revenue, selling and marketing expenses increased to 54% in 2010 from 22% in the prior year. The increases were primarily the result of increased commissions and travel costs associated with the larger sales force as well as a substantial increase in marketing and advertising activities in 2010 as part of our switch to a direct sales force model from a distributorship model.

Depreciation

Depreciation expense consists of depreciation of long-lived property and equipment. Depreciation expense remained relatively unchanged, decreasing to \$457,156 for the nine months ended September 30, 2010 from \$495,218 in the comparable prior year period.

Stock Options/Restricted Stock Compensation Expense

Stock options compensation expense consists of non-cash based stock compensation expense and non-cash expense associated with granting restricted stock to consultants. Stock options/restricted stock compensation expense increased \$780,911 to \$1,227,871 for the nine months ended September 30, 2010 from \$446,960 in the comparable year period. As a percentage of revenues, stock options compensation expense for the nine months ended September 30, 2010 was 12%, compared to 9% in the prior year due to the granting of restricted shares to consultants during the third quarter of 2010.

Interest Expense

Interest expense is from our promissory notes and convertible debt instruments. Interest expense for the nine months ended September 30, 2010 increased 102%, to \$680,418, as compared to the nine months ended September 30, 2009. The increase was the result of interest expense associated with the incurrence of convertible debt during the last half of 2009 and first half of 2010.

Change in Warrant Derivative Liability

For the nine months ended September 30, 2010, the Company recorded a non cash charge of \$6,826,533 associated with the issuance of warrants as part of its convertible debt financing, based upon the closing price of the Company's common stock on September 30, 2010.

Liquidity and Capital Resources

Since our inception, we have historically financed our operations through operating cash flows, as well as the private placement of equity securities and debt, and other debt transactions. Most recently, on June 30 and July 30, 2010, we raised approximately \$9,272,000 through a private placement of equity securities and conversion of a portion of a bridge loan financing. At September 30, 2010, we had approximately \$3,133,000 of cash and cash equivalents and accounts receivables. In addition, we have access to credit lines secured by certain of our accounts receivable balances. At September 30, 2010, we had convertible notes payable of approximately \$400,000.

Net cash used in operating activities for the nine months ended September 30, 2010 was \$5,889,896. This was primarily related to cash used to fund our operations as well as an increase of accounts receivable of approximately \$1,287,420 and an increase in our inventory balance of approximately \$1,981,835. For the nine months ended September 30, 2009, net cash used in operating activities was \$2,083,645 due to a lower net loss compared to 2010 resulting from our decision to go to a direct sales effort in the second half of 2009.

Net cash provided by financing activities was \$6,839,940 and \$1,922,508 for the nine months ended September, 2010 and 2009, respectively. The net cash provided from financing activities during 2010 was primarily the result of the sale of approximately \$4,700,000 in convertible debt instruments and the issuance of \$5,095,934 of common stock, net of issuance costs, in connection with the above referenced Reverse Merger and related financing transactions. These amounts were partially offset by principal payments on outstanding loan and lease obligations.

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 effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity or capital expenditures or capital resources that are material to an investor in our shares.

Cash Requirements

We believe that our accounts receivable credit facilities as well as our recent private placement of equity securities and cash flow from operations will be sufficient to meet our anticipated cash requirements through March 31, 2011 based upon the expected revenue levels and results of our operations. If we do not meet our revenue objectives over that period, we may need to sell additional equity securities, which could result in dilution to our stockholders, or seek additional loans. The incurrence of indebtedness would result in increased debt service obligations and could require us to agree to operating and financial covenants that would restrict our operations. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, could limit our ability to expand our business operations and could harm our overall business prospects.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Required.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures for financial reporting to give reasonable assurance that information required to be disclosed in our reports submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. These controls and procedures also give reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to management to allow timely decisions regarding required disclosures.

Our principal executive officer and principal financial officer, together with management, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2010, pursuant to Rule 13a-15(e) of the Exchange Act. Based on that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) were effective such that information relating to the Company, including our consolidated subsidiary, required to be disclosed in our SEC reports, (i) is recorded, processed, summarized and reported within the time frames specified in SEC rules and forms, and (ii) is accumulated and communicated to Company management, including our principal executive officer and

principal financial officer, as appropriate to allow timely discussion regarding disclosure.

Changes in Internal Control over Financial Reporting

We have previously reported in our prior periodic reports that, after conducting an evaluation of the Company's disclosure controls and procedures, as such term is defined in Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. We further indicated in our 10-Q filed November 13, 2009 for the quarter ended September 30, 2009, our first periodic report, that the reason for this was that our finances would not allow us to hire sufficient accounting staff or to implement appropriate procedures for the monitoring and review of our financial reporting function.

However, as a result of the closing of the Reverse Merger on June 30, 2010 (See Item 2 - Management Discussion and Analysis of Financial Condition and Results of Operation - Background and our Current Report on Form 8-K, filed with the SEC on July 7, 2010), in which all of our directors and officers were replaced and we changed our business from selling emergency preparedness kits to biomaterials research, development, and commercialization (the business of the company that effectively acquired us in the Reverse Merger), we have remedied our prior internal control deficiencies as we now have, among other things, a sophisticated board of directors and principal financial officer with substantial public company and accounting experience, as well as sufficient accounting staff and other resources, including access to outside accountants. In addition, we have now put into place numerous internal controls over financial reporting as of the last day of the quarter ended June 30, 2010 which did not previously exist. We believe these changes will materially affect, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls also can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we are involved in litigation and proceedings in the ordinary course of our business. We are not currently involved in any legal proceeding that we believe would have a material adverse effect on our business or financial condition.

ITEM 1A. RISK FACTORS.

Because we are a "smaller reporting company," we are not required to provide this information

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

Unregistered Sales of Equity Securities

Reference is made to the Company's Current Report on Form 8-K filed with the SEC on August 5, 2010 for information regarding unregistered sales of equity securities and use of proceeds by the Company during the quarter ended September 30, 2010.

ITEM 6. EXHIBITS.

- 3.1 Certificate of Incorporation (filed as Exhibit 3.1 to Form 8-K filed June 30, 2010, incorporated by reference herein)
- 3.2 Amended and Restated Bylaws (filed as Exhibit 3.2 to Form 8-K filed September 24, 2010, incorporated by reference herein)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

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.

BACTERIN INTERNATIONAL HOLDINGS, INC.

Date: November 15, 2010

By: /s/ Guy Cook
Name: Guy Cook
Title: President and Chief Executive Officer

Date: November 15, 2010

By: /s/ John P, Gandolfo
Name: John P, Gandolfo
Title: Chief Financial Officer