

Cardiovascular Systems Inc
Form 10-Q
May 03, 2019
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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 March 31, 2019
Commission File No. 000-52082

CARDIOVASCULAR SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware No. 41-1698056
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)
1225 Old Highway 8 Northwest
St. Paul, Minnesota 55112-6416
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code: (651) 259-1600

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES NO

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

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, One-tenth of One Cent (\$0.001) Par Value Per Share	CSII	The Nasdaq Stock Market LLC

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The number of shares outstanding of the registrant's common stock as of April 26, 2019 was: Common Stock, \$0.001 par value per share, 34,826,182 shares.

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PART I. — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Cardiovascular Systems, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share and share amounts)

(Unaudited)

	March 31, 2019	June 30, 2018
ASSETS		
Current assets		
Cash and cash equivalents	\$115,280	\$116,260
Accounts receivable, net	34,970	31,225
Inventories	19,304	16,605
Marketable securities	456	544
Prepaid expenses and other current assets	2,221	2,977
Total current assets	172,231	167,611
Property and equipment, net	27,607	27,744
Patents, net	5,242	5,231
Other assets	6,149	2,766
Total assets	\$211,229	\$203,352
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$12,396	\$10,441
Accrued expenses	26,489	25,776
Deferred revenue	1,612	1,243
Total current liabilities	40,497	37,460
Long-term liabilities		
Financing obligation	21,005	21,064
Deferred revenue	7,230	8,946
Other liabilities	884	1,412
Total liabilities	69,616	68,882
Commitments and contingencies (see Note 7)		
Common stock, \$0.001 par value; authorized 100,000,000 common shares; issued and outstanding 34,828,214 at March 31, 2019 and 33,360,032 at June 30, 2018, respectively	34	33
Additional paid in capital	472,501	461,927
Accumulated other comprehensive income	—	101
Accumulated deficit	(330,922)	(327,591)
Total stockholders' equity	141,613	134,470
Total liabilities and stockholders' equity	\$211,229	\$203,352

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

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Cardiovascular Systems, Inc.

Consolidated Statements of Operations

(Dollars in thousands, except per share and share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2019	2018	2019	2018
Net revenues	\$63,311	\$ 55,587	\$179,783	\$ 157,891
Cost of goods sold	12,166	9,969	34,218	28,670
Gross profit	51,145	45,618	145,565	129,221
Expenses:				
Selling, general and administrative	41,356	37,796	123,705	110,722
Research and development	9,282	7,333	23,937	20,037
Total expenses	50,638	45,129	147,642	130,759
Income (loss) from operations	507	489	(2,077)	(1,538)
Other (income) expense, net:				
Interest expense	420	429	1,266	1,291
Interest income and other, net	(671)	(338)	(1,771)	(903)
Total other (income) expense, net	(251)	91	(505)	388
Income (loss) before income taxes	758	398	(1,572)	(1,926)
Provision for income taxes	86	33	152	99
Net income (loss)	\$672	\$ 365	\$(1,724)	\$(2,025)
Basic earnings per share	\$0.02	\$ 0.01	\$(0.05)	\$(0.06)
Diluted earnings per share	\$0.02	\$ 0.01	\$(0.05)	\$(0.06)

Basic weighted average shares outstanding 33,600,148 33,237,552 33,510,368 33,105,174

Diluted weighted average shares outstanding 34,241,432 33,641,804 33,510,368 33,105,174

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

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Cardiovascular Systems, Inc.
 Consolidated Statements of Comprehensive Income (Loss)
 (Dollars in thousands)
 (Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2019	2018	2019	2018
Net income (loss)	\$672	\$365	\$(1,724)	\$(2,025)
Other comprehensive income:				
Unrealized (loss) gain on available for sale securities	—	(1)	—	27
Adjustment for net gain realized and included in interest income and other, net	—	(8)	—	(24)
Total change in unrealized gain on available for sale securities	—	(9)	—	3
Comprehensive income (loss)	\$672	\$356	\$(1,724)	\$(2,022)

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

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Cardiovascular Systems, Inc.
Consolidated Statements of Changes in Stockholders' Equity
(Dollars in thousands, except per share amounts)
(Unaudited)

	Common Stock	Additional Paid In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balances at June 30, 2018	\$ 33	\$ 461,927	\$ 101	\$ (327,591)	\$ 134,470
Impact from adoption of ASU 2016-01 (See Note 5)	—	—	(101)	101	—
Stock-based compensation related to restricted stock awards, net	—	3,132	—	—	3,132
Shares withheld for payroll taxes	—	—	—	(1,058)	(1,058)
Employee stock purchase plan activity	—	252	—	—	252
Exercise of stock options at \$8.75 per share	—	71	—	—	71
Net loss	—	—	—	(2,888)	(2,888)
Balances at September 30, 2018	33	465,382	—	(331,436)	133,979
Stock-based compensation related to restricted stock awards, net	1	2,471	—	—	2,472
Shares withheld for payroll taxes	—	—	—	(319)	(319)
Employee stock purchase plan activity	—	1,849	—	—	1,849
Exercise of stock options at \$8.75 per share	—	125	—	—	125
Net income	—	—	—	492	492
Balances at December 31, 2018	34	469,827	—	(331,263)	138,598
Stock-based compensation related to restricted stock awards, net	—	2,380	—	—	2,380
Shares withheld for payroll taxes	—	—	—	(331)	(331)
Employee stock purchase plan activity	—	294	—	—	294
Net income	—	—	—	672	672
Balances at March 31, 2019	\$ 34	\$ 472,501	\$ —	\$ (330,922)	\$ 141,613

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

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Cardiovascular Systems, Inc.

Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands, except per share amounts)

(Unaudited)

	Common Stock	Additional Paid In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balances at June 30, 2017	\$ 33	\$ 447,559	\$ 100	\$ (329,303)	\$ 118,389
Stock-based compensation related to restricted stock awards, net	—	3,129	—	—	3,129
Employee stock purchase plan activity	—	251	—	—	251
Exercise of stock options at \$7.90 per share	—	307	—	—	307
Unrealized gain on marketable securities	—	—	12	—	12
Net gain reclassified from accumulated other comprehensive income	—	—	(8)	—	(8)
Net loss	—	—	—	(1,977)	(1,977)
Balances at September 30, 2017	33	451,246	104	(331,280)	120,103
Stock-based compensation related to restricted stock awards, net	—	2,375	—	—	2,375
Employee stock purchase plan activity	—	1,680	—	—	1,680
Exercise of stock options at \$12.15 per share	—	207	—	—	207
Unrealized gain on marketable securities	—	—	16	—	16
Net gain reclassified from accumulated other comprehensive income	—	—	(8)	—	(8)
Net loss	—	—	—	(413)	(413)
Balances at December 31, 2017	33	455,508	112	(331,693)	123,960
Stock-based compensation related to restricted stock awards, net	—	1,880	—	—	1,880
Employee stock purchase plan activity	—	260	—	—	260
Unrealized loss on marketable securities	—	—	(1)	—	(1)
Net gain reclassified from accumulated other comprehensive income	—	—	(8)	—	(8)
Net income	—	—	—	365	365
Balances at March 31, 2018	\$ 33	\$ 457,648	\$ 103	\$ (331,328)	\$ 126,456

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

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Cardiovascular Systems, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	Nine Months Ended March 31,	
	2019	2018
Cash flows from operating activities		
Net loss	\$(1,724)	\$(2,025)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation of property and equipment	2,382	2,927
Amortization of patents	235	153
Write-off of patent costs	500	497
Provision for (recovery of) doubtful accounts (including note receivable)	125	(18)
Stock-based compensation	8,600	7,880
Changes in assets and liabilities		
Accounts receivable	(3,870)	(3,594)
Inventories	(2,699)	(105)
Prepaid expenses and other assets	647	2,879
Accounts payable	1,915	(544)
Accrued expenses and other liabilities	144	(6,945)
Deferred revenue	(1,347)	577
Net cash provided by operating activities	4,908	1,682
Cash flows from investing activities		
Purchases of property and equipment	(2,286)	(1,614)
Purchase of investment	(3,055)	—
Proceeds from convertible note receivable	—	143
Sales of marketable securities	97	144
Costs incurred in connection with patents	(665)	(880)
Net cash used in investing activities	(5,909)	(2,207)
Cash flows from financing activities		
Proceeds from employee stock purchase plan	1,551	1,385
Payment of employee taxes related to vested restricted stock	(1,708)	—
Exercise of stock options	196	513
Other	(18)	20
Net cash provided by financing activities	21	1,918
Net change in cash and cash equivalents	(980)	1,393
Cash and cash equivalents		
Beginning of period	116,260	107,912
End of period	\$115,280	\$109,305

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

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CARDIOVASCULAR SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(For the Nine Months Ended March 31, 2019 and 2018)
(Dollars in thousands, except per share and share amounts)
(Unaudited)

1. Basis of Presentation

Cardiovascular Systems, Inc. (the “Company”), based in St. Paul, Minnesota, is a medical device company focused on developing and commercializing innovative solutions for treating vascular and coronary disease. The Company’s Orbital Atherectomy Systems (“OAS”) treat calcified and fibrotic plaque in arterial vessels throughout the leg and heart in a few minutes of treatment time, and address many of the limitations associated with existing surgical, catheter and pharmacological treatment alternatives.

The Company prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements. The year-end consolidated balance sheet was derived from the Company’s audited consolidated financial statements, but does not include all disclosures as required by GAAP. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair statement of the Company’s consolidated financial position, the results of its operations, its changes in stockholders’ equity, and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Annual Report on Form 10-K filed by the Company with the SEC on August 23, 2018. The nature of the Company’s business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

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

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) 2016-02, “Leases.” The guidance requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, and should be applied using a modified retrospective approach. The guidance is effective for the Company on July 1, 2019.

The Company will elect the prospective transition method with the effects of adoption recognized as a cumulative effect adjustment to the opening balance of retained earnings in the Company’s fiscal 2020 financial statements, with no restatement of comparative periods. The Company will also elect the package of three practical expedients permitted under the transition guidance within the new standard, which among other things, allows the Company to carry forward the historical lease classification.

The Company is currently assessing the impact of adopting this guidance on its consolidated financial statements and related disclosures. The Company expects to record right of use assets and lease liabilities, which may be material, on its consolidated balance sheet upon adoption of this standard and is still assessing the impact to its results of

operations and cash flows.

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2. Selected Consolidated Financial Statement Information

Accounts Receivable, Net

Accounts receivable consists of the following:

	March 31, 2019	June 30, 2018
Accounts receivable	\$35,649	\$32,025
Less: Allowance for doubtful accounts	(679)	(800)
Accounts receivable, net	\$34,970	\$31,225

Inventories

Inventories consist of the following:

	March 31, 2019	June 30, 2018
Raw materials	\$6,042	\$6,820
Work in process	1,612	1,315
Finished goods	11,650	8,470
Inventories	\$19,304	\$16,605

Property and Equipment, Net

Property and equipment consists of the following:

	March 31, 2019	June 30, 2018
Land	\$500	\$500
Building	22,420	22,420
Equipment	17,869	16,510
Furniture	2,900	2,709
Leasehold improvements	540	438
Construction in progress	1,682	1,110
	45,911	43,687
Less: Accumulated depreciation	(18,304)	(15,943)
Property and equipment, net	\$27,607	\$27,744

Accrued Expenses

Accrued expenses consist of the following:

	March 31, 2019	June 30, 2018
Salaries and bonus	\$7,089	\$6,624
Commissions	6,310	7,234
Accrued vacation	4,094	3,557
Accrued excise, sales and other taxes	3,555	3,522

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Clinical studies	1,968	1,422
Legal settlement	932	1,847
Other accrued expenses	2,541	1,570
Accrued expenses	\$26,489	\$25,776

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3. Revenue

Effective July 1, 2018 the Company adopted Accounting Standards Codification (“ASC”) Topic 606 - Revenue from Contracts with Customers using the modified retrospective adoption method. Adoption did not have a material impact on the Company’s financial statements.

The Company sells its peripheral and coronary products to customers through a direct sales force in the United States and through distributors internationally and has no material concentration of credit risk or significant payment terms extended to customers and, therefore, the Company does not adjust the promised amount of consideration for the effects of a significant financing component. Sales, use, value-added, and other excise taxes are not recognized in revenue. The Company has elected to present revenue net of sales taxes and other similar taxes.

The following table disaggregates the Company’s net revenues by product category and geography for the following periods:

Product Category	Three Months		Nine Months	
	Ended		Ended	
	2019	2018	2019	2018
Peripheral	\$45,152	\$40,989	\$130,620	\$118,331
Coronary	18,159	14,598	49,163	39,560
Total net revenues	\$63,311	\$55,587	\$179,783	\$157,891

Geography

United States	\$60,897	\$54,736	\$174,417	\$157,040
International	2,414	851	5,366	851
Total net revenues	\$63,311	\$55,587	\$179,783	\$157,891

Performance Obligations

The majority of the Company’s revenues are from customer arrangements containing a single performance obligation to transfer peripheral and coronary products, and thus revenue is recognized at a point in time when control is transferred. This generally occurs upon shipment or upon delivery to the customer site, based on the contract terms. Shipping and handling activities are considered to be fulfillment activities and are not considered to be a separate performance obligation. The Company does not assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer. The Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. The Company did not recognize any material revenue in the current reporting period for performance obligations that were fully satisfied in previous periods.

Significant Judgments

The Company has an exclusive distribution agreement with Medikit to sell the Company’s coronary and peripheral OAS in Japan. To secure exclusive distribution rights, Medikit made an upfront payment of \$10,000 to the Company, which is partially refundable based on the occurrence of certain events during the term of the agreement. The Company has classified the payment as current or long-term based on its expectation of when revenue will be recognized and this expectation is re-evaluated on a quarterly basis. Medikit also provides advance payments for orders under the terms of the agreement, and, therefore, deferred revenue is recorded until products are accepted by Medikit. Revenue of \$775 was recognized in the nine months ended March 31, 2019 that was deferred as of June 30, 2018.

Revenue is recognized at the transaction price to which the Company expects to be entitled. The Company offers customers certain volume-based rebates, discounts, and incentives. Estimates of variable consideration from these

items are taken into account using the most-likely amount method based on contractual provisions, the Company's historical experience, and forecasted customer buying patterns. These items are recognized as a reduction to revenue in the period the revenue is recognized and recorded as a liability. As of March 31, 2019 and June 30, 2018, the Company had a liability of \$1,665 and \$1,398, respectively, related to these items and recorded within accounts payable on the consolidated balance sheet.

Return and warranty obligations vary by the specific terms of agreements with customers. The Company generally does not provide customers with a right of return. The Company has a limited warranty provision for goods that are nonconforming or defective at the time of shipment, which is estimated based on historical experience.

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Contract Costs

Commissions are earned by the Company's direct sales force based on sales of the Company's OAS and other products. The Company applies the practical expedient and recognizes commissions as an expense when incurred because the amortization period of the asset that the Company would have otherwise recognized is one year or less.

4. Debt

Revolving Credit Facility

In March 2017, the Company entered into a Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank ("SVB"). The Loan Agreement provides for a senior, secured revolving credit facility (the "Revolver") of \$40,000 (the "Maximum Dollar Amount").

Advances under the Revolver may be made from time to time up to the Maximum Dollar Amount, subject to certain borrowing limitations. The Revolver has a maturity date of March 31, 2020 and bears interest at a floating per annum rate equal to the Wall Street Journal prime rate, less 0.25%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings up to \$10,000 are available on a non-formula basis. Borrowings above \$10,000 are based on (i) 85% of eligible domestic accounts receivable, and (ii) the lesser of 50% of eligible inventory or \$5,000, subject to adjustment as defined in the Loan Agreement. Upon the Revolver's maturity, any outstanding principal balance, unpaid accrued interest, and all other obligations under the Revolver will be due and payable. The Company will incur a fee equal to 1% of the Maximum Dollar Amount upon termination of the Loan Agreement or the Revolver for any reason prior to the maturity date, unless refinanced with SVB.

The Company's obligations under the Loan Agreement are secured by certain of the Company's assets, including, among other things, accounts receivable, deposit accounts, inventory, equipment, general intangibles and records pertaining to the foregoing. The collateral does not include the Company's intellectual property, but the Company has agreed not to encumber its intellectual property without the consent of SVB. The Loan Agreement contains customary covenants limiting the Company's ability to, among other things, incur debt or liens, make certain investments and loans, enter into transactions with affiliates, undergo certain fundamental changes, dispose of assets, or change the nature of its business. In addition, the Loan Agreement contains financial covenants requiring the Company to maintain, at all times when any amounts are outstanding under the Revolver, either (i) minimum unrestricted cash at SVB and unused availability on the Revolver of at least \$10,000 or (ii) minimum trailing three-month Adjusted EBITDA of \$1,000. If the Company does not comply with the various covenants under the Loan Agreement, the interest rate on outstanding amounts will increase by 5% and SVB may, subject to various customary cure rights, decline to provide additional advances under the Revolver, require the immediate payment of all amounts outstanding under the Revolver, and foreclose on all collateral.

Under the Loan Agreement, the Company paid SVB a non-refundable commitment fee of \$80, which will be amortized to interest expense over the term of the Loan Agreement. The Company is required to pay a fee equal to 0.35% per annum on the unused portion of the Revolver, payable quarterly in arrears. The Company is not obligated to draw any funds under the Revolver and has not done so under the Revolver since entering into the Loan Agreement. No amounts are outstanding as of March 31, 2019.

Financing Obligation

In March 2017, in connection with the sale of the Company's headquarters facility in St. Paul, Minnesota (the "Facility"), the Company entered into a Lease Agreement to lease the Facility. The Lease Agreement has an initial term of fifteen years, with four consecutive renewal options of five years each at the Company's option, with a base annual rent in the first year of \$1,638 and annual escalations of 3% thereafter. Rent during subsequent renewal terms will be at the then

fair market rental rate. As the lease terms resulted in a capital lease classification, the Company accounted for the sale and leaseback of the Facility as a financing transaction where the assets remain on the Company's balance sheet and a financing obligation was recorded for \$20,944. As lease payments are made, they will be allocated between interest expense and a reduction of the financing obligation, resulting in a value of the financing obligation that is equivalent to the net book value of the assets at the end of the lease term. The effective interest rate is 7.89%. At the end of the lease (including any renewal option terms), the Company will remove the assets and financing obligation from its balance sheet.

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Payments under the initial term of the Lease Agreement as of March 31, 2019 are as follows:

Three months ending June 30, 2019	\$434
Fiscal 2020	1,750
Fiscal 2021	1,803
Fiscal 2022	1,857
Fiscal 2023	1,913
Thereafter	19,375
	\$27,132

5. Investments

The following table provides information by level for the Company's marketable securities that were measured at fair value on a recurring basis:

	Fair Value	Fair Value Measurements as of March 31, 2019 Using Inputs Considered as		
	Fair Value	Level 1	Level 2	Level 3
Mutual funds	\$ 456	\$ 148	\$ 308	\$ —
Total short-term investments	\$ 456	\$ 148	\$ 308	\$ —

	Fair Value	Fair Value Measurements as of June 30, 2018 Using Inputs Considered as		
	Fair Value	Level 1	Level 2	Level 3
Mutual funds	\$ 544	\$ 199	\$ 345	\$ —
Total short-term investments	\$ 544	\$ 199	\$ 345	\$ —

Effective July 1, 2018 the Company adopted the provisions of ASU 2016-01. Unrealized gains and losses of marketable securities previously recognized in other comprehensive income will now be recognized in net income as a component of other income. Upon adoption, the Company recorded a cumulative-effect reclassification adjustment of \$101 from accumulated other comprehensive income to the opening balance of retained earnings as of July 1, 2018.

During the three and nine months ended March 31, 2019 and 2018, there were no purchases of marketable securities. There was \$0 and \$97 of marketable securities that were sold during the three and nine months ended March 31, 2019, respectively. There was \$48 and \$144 of marketable securities that were sold during the three and nine months ended March 31, 2018, respectively.

The Company's marketable securities classified within Level 1 are valued using real-time quotes for transactions in active exchange markets. Marketable securities within Level 2 are valued using readily available pricing sources. There were no transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the nine months ended March 31, 2019. Any transfers between levels would be recognized on the date of the event or when a change in circumstances causes a transfer.

The Company holds an equity investment that does not have a readily determined fair value. The Company has elected to measure this investment at cost minus impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Impairment is reviewed each reporting period by performing a qualitative assessment considering impairment indicators to evaluate whether the investment is impaired. As of March 31, 2019 and June 30, 2018, the carrying value of the investment was \$5,593 and \$2,538, respectively. During the nine months ended March 31, 2019, no impairment indicators were noted. The investment is recorded within other long term assets on the consolidated balance sheet.

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6. Stock Options and Restricted Stock Awards

On November 15, 2017, the Company's stockholders approved the 2017 Equity Incentive Plan (the "2017 Plan") for the purpose of granting equity awards to employees, directors and consultants. The 2017 Plan replaced the 2014 Equity Incentive Plan (the "2014 Plan"), and no further equity awards may be granted under the 2014 Plan or the 2007 Equity Incentive Plan (the "2007 Plan") (the 2017 Plan, 2014 Plan and the 2007 Plan are collectively referred to as the "Plans").

Equity awards classified as restricted stock and performance-based restricted stock are treated as issued shares when granted; however, these shares are not included in the computation of basic weighted average shares outstanding. When shares vest, unless the holder elects to pay the payroll tax liability in cash or through a sale of shares, the Company withholds the appropriate amount of shares to settle the payroll tax liability, on behalf of the individual receiving the shares, as an adjustment to accumulated deficit.

Stock Options

All options granted under the Plans become exercisable over periods established at the date of grant. The option exercise price is generally not less than the estimated fair market value of the Company's common stock at the date of grant, as determined by the Company's management and Board of Directors. An employee's vested options must be exercised at or within 90 days of termination to avoid forfeiture.

Stock option activity for the nine months ended March 31, 2019 is as follows:

	Number of Options ^(a)	Weighted Average Exercise Price
Options outstanding at June 30, 2018	22,321	\$ 8.75
Options exercised	(22,321)	\$ 8.75
Options outstanding at March 31, 2019	—	\$ —

(a) Includes the effect of options granted, exercised, forfeited or expired from the 2007 Plan.

Restricted Stock

The value of each restricted stock award is equal to the fair market value of the Company's common stock at the date of grant. Vesting of time-based restricted stock awards ranges from one to three years. The estimated fair value of restricted stock awards, including the effect of estimated forfeitures, is recognized on a straight-line basis over the restricted stock's vesting period.

Restricted stock award activity for the nine months ended March 31, 2019 is as follows:

	Number of Shares	Weighted Average Fair Value
Outstanding at June 30, 2018	455,216	\$ 24.77
Granted	259,010	\$ 35.46
Forfeited	(20,889)	\$ 28.39
Vested	(209,142)	\$ 23.27
Outstanding at March 31, 2019	484,195	\$ 30.76

Performance-Based Restricted Stock

The Company also grants performance-based restricted stock awards to certain executives and other management. In August 2018, the Company granted an aggregate maximum of 210,020 shares that vest based on the Company's total shareholder return relative to total shareholder return of the Company's peer group (a market condition), as measured by the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2018 compared to the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2021. Vesting of these awards will be determined on the date that the Company's Annual Report on Form 10-K for the fiscal year ending June 30, 2021 is filed.

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To calculate the estimated fair value of these restricted stock awards with market conditions, the Company uses a Monte Carlo simulation, which uses the expected average stock prices to estimate the expected number of shares that will vest. The Monte Carlo simulation resulted in an aggregate fair value of approximately \$4,734, which the Company will recognize as expense using the straight-line method over the period that the awards are expected to vest. Stock-based compensation expense related to an award with a market condition will be recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided.

Performance-based restricted stock awards granted in fiscal 2017 and 2018 that are outstanding vest based on the Company's total shareholder return relative to total shareholder return of the Company's peer group (a market condition), as measured by the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2016 and July 1, 2017, respectively, compared to the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2019 and July 1, 2020, respectively.

Performance-based restricted stock award activity for the nine months ended March 31, 2019 is as follows:

	Number of Shares	Weighted Average Fair Value
Outstanding at June 30, 2018	531,178	\$ 12.69
Granted	225,325	\$ 22.33
Forfeited	(2,172)	\$ 17.94
Outstanding at March 31, 2019	754,331	\$ 15.19

7. Commitment and Contingencies

Operating Leases

The Company leases manufacturing space and equipment under lease agreements that expire at various dates through March 2020. Rental expenses were \$132 and \$157 for the three months ended March 31, 2019 and 2018, respectively, and \$410 and \$496 for the nine months ended March 31, 2019 and 2018, respectively.

Future minimum lease payments under the agreements as of March 31, 2019 are as follows:

Three months ending June 30, 2019	\$ 127
Fiscal 2020	392
Fiscal 2021	36
Fiscal 2022	8
Fiscal 2023	3
Thereafter	2
	\$568

Other Matters

In the ordinary conduct of business, the Company is subject to various lawsuits and claims covering a wide range of matters including, but not limited to, employment claims and commercial disputes. While the outcome of these matters is uncertain, the Company does not believe there are any significant matters as of March 31, 2019 that are probable or estimable, for which the outcome could have a material adverse impact on its consolidated balance sheets or statements of operations.

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8. Earnings Per Share

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted earnings per common share computations (in thousands except share and per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2019	2018	2019	2018
Numerator				
Net income (loss)	\$672	\$ 365	\$(1,724)	\$(2,025)
Income allocated to participating securities	(3)	(5)	—	—
Net income (loss) available to common stockholders	\$669	\$ 360	\$(1,724)	\$(2,025)
Denominator				
Weighted average common shares outstanding – basic	33,600,448	33,237,552	33,510,368	33,105,174
Effect of dilutive stock options ⁽¹⁾	—	14,197	—	—
Effect of dilutive restricted stock units ⁽²⁾	339,929	318,122	—	—
Effect of performance-based restricted stock awards ⁽³⁾	295,048	67,918	—	—
Effect of employee stock purchase plan ⁽⁴⁾	6,307	4,015	—	—
Weighted average common shares outstanding – diluted	34,241,432	33,641,804	33,510,368	33,105,174
Earnings per common share – basic	\$0.02	\$ 0.01	\$(0.05)	\$(0.06)
Earnings per common share – diluted	\$0.02	\$ 0.01	\$(0.05)	\$(0.06)

At March 31, 2019 and 2018, 0 and 22,321 stock options, respectively, were outstanding. The effect of the shares (1) that would be issued upon exercise of these options has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2019 and 2018, because those shares are anti-dilutive.

At March 31, 2019 and 2018, 354,176 and 335,869 additional shares of common stock, respectively, were issuable (2) upon the settlement of outstanding restricted stock units. The effect of the shares that would be issued upon settlement of these restricted stock units has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2019 and 2018, because those shares are anti-dilutive.

At March 31, 2019 and 2018, 754,331 and 531,178 performance-based restricted stock awards, respectively, were (3) outstanding. The effect of the potential vesting of these awards has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2019 and 2018, because those shares are anti-dilutive.

At March 31, 2019 and 2018, the Company included the number of shares that would be issued under its employee (4) stock purchase plan based on the aggregate expected amount of withholdings and the average unrecognized compensation expense as assumed proceeds. The effect of these shares has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2019 and 2018, because those shares are anti-dilutive.

Unvested time-based restricted stock awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this method, earnings attributable to the Company are allocated between common stockholders and the participating awards, as if the awards were a second class of stock. During periods of net income, the calculation of earnings per share excludes the income attributable to participating securities in the numerator and the dilutive impact of these securities from the denominator. In the event of a net loss, undistributed earnings are not allocated to participating securities and the denominator excludes the dilutive impact of these securities as they do not share in the losses of the Company. During the three months ended March 31, 2019 and 2018, undistributed earnings allocated to participating securities were based on 172,839 and 462,387 time-based restricted stock awards, respectively.

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 1 of Part I of this Quarterly Report on Form 10-Q. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy for our business and expected financial results, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" discussed in our Annual Report on Form 10-K for the year ended

June 30, 2018 and subsequent Quarterly Reports on Form 10-Q, including in Item 1A of Part II of this Quarterly Report on Form 10-Q, for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

OVERVIEW

We are a medical technology company leading the way in the effort to successfully treat patients suffering from peripheral and coronary artery diseases, including those with arterial calcium, the most difficult arterial disease to treat. We are committed to clinical rigor, constant innovation and a defining drive to set the industry standard to deliver safe and effective medical devices that improve lives of patients facing these difficult disease states.

We have observed some degree of seasonality in our business, as there tends to be a lower number of procedures that use our products during the three months ending September 30. Interventional procedure volume usually grows throughout the course of the fiscal year, with the three months ending June 30 usually representing the highest volume of cases and, therefore, the highest amount of revenue generated by us during the course of the fiscal year.

Peripheral

Our peripheral arterial disease ("PAD") products are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee, including calcified plaque, and address many of the limitations associated with other existing surgical, catheter and pharmacological treatment alternatives. The micro-invasive devices use small access sheaths that can provide procedural benefits, allow physicians to treat PAD patients in even the small and tortuous vessels located below the knee, and facilitate access through alternative sites in the ankle, foot and wrist, as well as in the groin. We refer to each of the PAD products in this report as the "Peripheral OAS."

The United States Food and Drug Administration ("FDA") has granted us 510(k) clearances for our Peripheral OAS as a therapy in patients with PAD, as discussed in Item 1 of Part I of our Annual Report on Form 10-K for the year ended June 30, 2018.

Coronary

Our coronary arterial disease ("CAD") product, the Diamondback 360 Coronary OAS ("Coronary OAS"), is marketed as a treatment for severely calcified coronary arteries. The Coronary OAS is a catheter-based platform designed to facilitate stent delivery in patients with CAD who are acceptable candidates for percutaneous transluminal coronary angioplasty or stenting due to de novo, severely calcified coronary artery lesions. The Coronary OAS design is similar to technology used in our Peripheral OAS, customized specifically for the coronary application.

In October 2013, we received premarket approval from the FDA to market the Coronary OAS as a treatment for severely calcified coronary arteries and we commenced a commercial launch that same month.

International

We commercialized our Coronary OAS Micro Crown in Japan in February 2018 through our distributor, Medikit Co., Ltd. In January 2019, we announced that Japan's Ministry of Health, Labor and Welfare approved our Coronary OAS Classic Crown, and in the third quarter of fiscal 2019, sales of this product commenced in Japan.

In fiscal 2019, we announced the first commercial use of Peripheral OAS outside of the United States, which occurred in Hong Kong, Germany, and the Middle East through our international distributor, OrbusNeich. We continue to evaluate and pursue additional international markets to expand the coronary and peripheral opportunities.

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CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements requires us to make estimates, assumptions and judgments that affect amounts reported in those statements. Our estimates, assumptions and judgments, including those related to revenue recognition, deferred revenue and stock-based compensation, are updated as appropriate at least quarterly. We use authoritative pronouncements, our technical accounting knowledge, cumulative business experience, judgment and other factors in the selection and application of our accounting policies. While we believe that the estimates, assumptions and judgments that we use in preparing our consolidated financial statements are appropriate, these estimates, assumptions and judgments are subject to factors and uncertainties regarding their outcome. Therefore, actual results may materially differ from these estimates.

Some of our significant accounting policies require us to make subjective or complex judgments or estimates. An accounting estimate is considered to be critical if it meets both of the following criteria: (1) the estimate requires assumptions about matters that are highly uncertain at the time the accounting estimate is made, and (2) different estimates that reasonably could have been used, or changes in the estimate that are reasonably likely to occur from period to period, would have a material impact on the presentation of our financial condition, results of operations, or cash flows.

Our critical accounting policies are identified in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 in Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Critical Accounting Policies and Significant Judgments and Estimates." There have been no changes in our critical accounting policies other than our adoption of ASC Topic 606 - Revenue from Contracts with Customers. See Note 3 to our Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q for additional discussion.

RESULTS OF OPERATIONS

The following table sets forth our results of operations expressed as dollar amounts (in thousands) and the changes between the specified periods expressed as percent increases or decreases:

	Three Months Ended			Nine Months Ended		
	March 31,		Percent Change	March 31,		Percent Change
	2019	2018		2019	2018	
Net revenues	\$63,311	\$55,587	13.9 %	\$179,783	\$157,891	13.9 %
Cost of goods sold	12,166	9,969	22.0	34,218	28,670	19.4
Gross profit	51,145	45,618	12.1	145,565	129,221	12.6
Expenses:						
Selling, general and administrative	41,356	37,796	9.4	123,705	110,722	11.7
Research and development	9,282	7,333	26.6	23,937	20,037	19.5
Total expenses	50,638	45,129	12.2	147,642	130,759	12.9
Income (loss) from operations	507					