TANDEM DIABETES CARE INC
Form 10-Q
July 28, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to

Commission File Number 001-36189

Tandem Diabetes Care, Inc.

(Exact name of registrant as specified in its charter)

Delaware	20-4327508
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11045 Roselle Street	
San Diego, California	92121
(Address of principal executive offices)	(Zip Code)

(858) 366-6900

Registrant's telephone number, including area code

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, par value $0.001 per share	The NASDAQ Stock Market LLC

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 x 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 x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of July 25, 2016, there were 30,613,826 shares of the registrant's Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TANDEM DIABETES CARE, INC.

CONDENSED BALANCE SHEETS

(In thousands, except par value)

	June 30, 2016 (Unaudited)	December 31, 2015 (Note 1)
Assets		
Current assets:		
Cash and cash equivalents	$ 30,250	$ 43,088
Restricted cash	2,000	2,000
Short-term investments	24,068	28,018
Accounts receivable, net	9,426	14,055
Inventory	21,692	17,543
Prepaid and other current assets	3,445	2,280
Total current assets	90,881	106,984
Property and equipment, net	16,242	15,526
Patents, net	1,947	2,110
Other long-term assets	120	105
Total assets	$ 109,190	$ 124,725
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 6,841	$ 5,234
Accrued expense	2,177	2,121
Employee-related liabilities	10,952	11,761
Deferred revenue	1,763	1,822
Other current liabilities	5,332	5,582
Total current liabilities	27,065	26,520
Notes payable—long-term	44,398	29,275
Deferred rent—long-term	2,207	2,743
Other long-term liabilities	3,447	2,719
Total liabilities	77,117	61,257
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock, $0.001 par value; 100,000 shares authorized as of June 30, 2016 and December 31, 2015, 30,613 and 30,255 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively.	31	30
Additional paid-in capital	391,981	384,551
Accumulated other comprehensive income	3	20

Accumulated deficit	(359,942)	(321,133)
Total stockholders’ equity	32,073	63,468
Total liabilities and stockholders’ equity	$ 109,190	$ 124,725

See accompanying notes to unaudited condensed financial statements.

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TANDEM DIABETES CARE, INC.

CONDENSED STATEMENTS OF OPERATIONS and comprehensive loss

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Sales	$22,985	$15,706	$43,043	$28,014
Cost of sales	14,809	10,905	27,939	20,406
Gross profit	8,176	4,801	15,104	7,608
Operating expenses:				
Selling, general and administrative	21,087	19,599	43,084	38,954
Research and development	4,142	3,873	8,310	7,735
Total operating expenses	25,229	23,472	51,394	46,689
Operating loss	(17,053)	(18,671)	(36,290)	(39,081)
Other income (expense), net:				
Interest and other income	107	61	225	160
Interest and other expense	(1,379)	(923)	(2,744)	(1,821)
Total other expense, net	(1,272)	(862)	(2,519)	(1,661)
Net loss	$(18,325)	$(19,533)	$(38,809)	$(40,742)
Other comprehensive loss:				
Unrealized gain (loss) on short-term investments	$(37)	$(39)	$(17)	$29
Comprehensive loss	$(18,362)	$(19,572)	$(38,826)	$(40,713)
Net loss per share, basic and diluted	$(0.60)	$(0.65)	$(1.28)	$(1.47)
Weighted average shares used to compute basic and diluted net loss per share	30,489	29,902	30,392	27,723

See accompanying notes to unaudited condensed financial statements.

TANDEM DIABETES CARE, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30,	
	2016	2015
Operating activities		
Net loss	$(38,809)	$(40,742)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	2,718	2,414
Interest expense related to amortization of debt discount and debt issuance costs	142	71
Provision for allowance for doubtful accounts	601	(100)
Provision for inventory reserve	—	101
Payment in kind interest accrual of notes payable	440	—
Amortization of discount on short-term investments	(19)	(37)
Stock-based compensation expense	5,828	7,033
Gain (loss) on disposal of property and equipment	(84)	14
Other	(21)	(77)
Changes in operating assets and liabilities:		
Accounts receivable, net	4,028	279
Inventory	(4,108)	(2,892)
Prepaid and other current assets	(1,165)	(249)
Other long-term assets	(15)	(17)
Accounts payable	1,731	1,388
Accrued expense	78	(933)
Employee-related liabilities	(809)	(1,045)
Deferred revenue	(58)	198
Other current liabilities	403	(47)
Deferred rent	(453)	(308)
Other long-term liabilities	135	769
Net cash used in operating activities	(29,437)	(34,180)
Investing activities		
Purchase of short-term investments	(22,657)	(58,993)
Proceeds from sales and maturities of short-term investments	26,750	43,450
Purchase of property and equipment	(4,048)	(2,351)
Purchase of patents	—	(74)
Net cash provided by (used in) investing activities	45	(17,968)
Financing activities		
Issuance of notes payable, net of issuance costs	14,994	—
Proceeds from public offering, net of offering costs	—	64,862
Proceeds from issuance of common stock	1,560	2,031
Net cash provided by financing activities	16,554	66,893
Net (decrease) increase in cash and cash equivalents	(12,838)	14,745
Cash and cash equivalents at beginning of period	43,088	31,176
Cash and cash equivalents at end of period	$30,250	$45,921
Supplemental disclosures of cash flow information		

Interest paid	$2,099	$1,735
Supplemental schedule of noncash investing and financing activities		
Lease incentive - lessor-paid tenant improvements	$—	$933
Debt issuance cost included in other long-term liabilities	$454	$—
Property and equipment included in accounts payable	$595	$1,510

See accompanying notes to unaudited condensed financial statements.

TANDEM DIABETES CARE, INC.

NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

1. Organization and Basis of Presentation

The Company

Tandem Diabetes Care, Inc. is a medical device company focused on the design, development and commercialization of a family of products for people with insulin-dependent diabetes. The Company is incorporated in the state of Delaware. Unless the context requires otherwise, the terms the “Company” or “Tandem” refer to Tandem Diabetes Care, Inc.

The Company currently manufactures and sells three insulin pump products in the United States that are designed to address large and differentiated needs of the insulin-dependent diabetes market:

- the t:slim® Insulin Delivery System, or t:slim, the Company’s flagship product that can easily and discreetly fit into a pocket,
- the t:flex® Insulin Delivery System, or t:flex, for people with greater insulin needs, and
- the t:slim G4™ Insulin Delivery System, or t:slim G4, a Continuous Glucose Monitoring (“CGM”) enabled pump with touch-screen simplicity.

The Company designed and commercialized its products based on its proprietary technology platform and consumer-focused approach. The Company began commercial sales of its first product, t:slim, in August 2012. During 2015, the Company commenced commercial sales of two additional insulin pumps: t:flex in May 2015 and t:slim G4 in September 2015.

Basis of Presentation

The Company has prepared the accompanying unaudited condensed financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments which are of a normal and recurring nature, considered necessary for a fair

presentation of the financial information contained herein, have been included.

Interim financial results are not necessarily indicative of results anticipated for the full year or any other period(s). These unaudited condensed financial statements should be read in conjunction with the Company’s audited financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, from which the balance sheet information herein was derived but excludes disclosures required by GAAP for complete financial statements.

2. Summary of Significant Accounting Policies

There have been no significant changes in our significant accounting policies during the six months ended June 30, 2016, as compared with those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

Use of Estimates

The preparation of the financial statements in conformity with U.S. GAAP requires management to make informed estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities in the Company’s financial statements and accompanying notes as of the date of the financial statements. Actual results could materially differ from those estimates and assumptions.

Restricted Cash

Restricted cash as of June 30, 2016 and December 31, 2015 was comprised of a $2.0 million minimum cash balance requirement in connection with the Company’s Term Loan Agreement, as amended by Consent and Amendment Agreement, dated June 20, 2014, Omnibus Amendment Agreement No. 2, dated February 23, 2015 and Amendment No. 3 to Term Loan Agreement, dated January 8, 2016 with Capital Royalty Partners II, L.P. and its affiliate funds (“Capital Royalty Partners”) (as amended, the “Term Loan Agreement”) (see Note 6, “Term Loan Agreement”).

Accounts Receivable

The Company grants credit to various customers in the normal course of business. The Company maintains an allowance for doubtful accounts for potential credit losses. Provisions are made, generally, for receivables greater than 120 days past due and based upon a specific review of other outstanding invoices. Uncollectible accounts are written off against the allowance after appropriate collection efforts have been exhausted and when it is deemed that a balance is uncollectible.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, accrued expense, and employee-related liabilities are reasonable estimates of their fair values because of the short-term nature of these assets and liabilities. Short-term investments and foreign exchange forward contracts that are not designated as hedges are carried at fair value. Based on the borrowing rates currently available for loans with similar terms, the Company believes that the fair value of its long-term notes payable approximates its carrying value.

Revenue Recognition

Revenue is generated from sales, in the United States, of insulin pumps, disposable cartridges and infusion sets to individual customers and third-party distributors that resell the product to insulin-dependent diabetes customers. The Company is paid directly by customers who use the products, distributors and third-party insurance payors.

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred and title passed, the price is fixed or determinable, and collectability is reasonably assured. These criteria are applied as follows:

The evidence of an arrangement generally consists of contractual arrangements with distributors, third-party insurance payors or direct customers.

Transfer of title and risk and rewards of ownership are passed upon shipment of the pump to distributors or upon delivery to the customer.

The selling prices are fixed and agreed upon based on the contracts with distributors, the customer and contracted insurance payors, if applicable. For sales to customers associated with insurance providers with whom there is no contract, revenue is recognized upon collection of cash, at which time the price is determinable. The Company generally does not offer rebates to its distributors and customers.

The Company considers the overall creditworthiness and payment history of the distributor, customer and the contracted insurance payor in determining whether collectability is reasonably assured.

Revenue Recognition for Arrangements with Multiple Deliverables

The Company considers the deliverables in its product offering as separate units of accounting and recognizes deliverables as revenue upon delivery only if (i) the deliverable has standalone value and (ii) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is probable and substantially controlled by the Company. The Company allocates consideration to the separate units of accounting, unless the undelivered elements were deemed perfunctory and inconsequential. The Company uses the relative selling price method, in which allocation of consideration is based on vendor-specific objective evidence (“VSOE”) if available, third-party evidence (“TPE”), or if VSOE and TPE are not available, management’s best estimate of a standalone selling price (“ESP”) for the undelivered elements.

The Company offers a cloud-based data management application, t:connect, which is made available to customers upon purchase of any of its insulin pumps. This service is deemed an undelivered element at the time of the insulin pump sale. Because the Company has neither VSOE nor TPE for this deliverable, the allocation of revenue is based on the Company’s ESP. The Company establishes its ESP based on the estimated cost to provide such services, including consideration for a reasonable profit margin, which is then corroborated by comparable market data. The Company allocates fair value based on management’s ESP to this element at the time of sale and is recognizing the revenue over the four-year hosting period. At June 30, 2016 and December 31, 2015, $1.3 million and $1.1 million, respectively, were recorded as deferred revenue for the t:connect hosting service. All other undelivered elements at the time of sale are deemed inconsequential or perfunctory.

Product Returns

The Company offers a 30-day right of return to its customers from the date of shipment of any of its insulin pumps, provided a physician's confirmation of the medical reason for the return is received. Estimated allowances for sales returns are based on historical returned quantities as compared to pump shipments in those same periods of return. The return rate is then applied to the sales of the current period to establish a reserve at the end of the period. The return rates used in the reserve are adjusted for known or expected changes in the marketplace when appropriate. The allowance for product returns is recorded as a reduction of revenue and accounts receivable in the period in which the related sale is recorded. The amounts recorded on the Company's balance sheet for product return allowance were $0.2 million and $0.3 million at June 30, 2016 and December 31, 2015, respectively. Actual product returns have not differed materially from estimated amounts reserved in the accompanying condensed financial statements.

Warranty Reserve

The Company generally provides a four-year warranty on its insulin pumps to end user customers and may replace any pumps that do not function in accordance with the product specifications. Insulin pumps returned to the Company may be refurbished and redeployed. Additionally, the Company offers a six-month warranty on disposable cartridges and infusion sets. Estimated warranty costs are recorded at the time of shipment. Warranty costs are estimated based on the current expected replacement product cost and expected replacement rates based on historical experience. The Company evaluates the reserve quarterly and makes adjustments when appropriate. Changes to the actual replacement rates could have a material impact on the Company's estimated liability.

At June 30, 2016 and December 31, 2015, the warranty reserve was $4.6 million and $3.5 million, respectively. The following table provides a reconciliation of the change in product warranty liabilities through June 30, 2016 (in thousands):

Balance at December 31, 2015	$3,547
Provision for warranties issued during the period	3,863
Settlements made during the period	(4,003)
Increases in warranty estimates	1,242
Balance at June 30, 2016	$4,649
Current portion	$2,018
Non-current portion	2,631
Total	$4,649

Stock-Based Compensation

Stock-based compensation cost is measured at the grant date based on the estimated fair value of the award, and the portion that is ultimately expected to vest is recognized as compensation expense over the requisite service period on a straight-line basis. The Company estimates the fair value of stock options issued under the 2013 Stock Incentive Plan (“2013 Plan”) and shares issued under the Employee Stock Purchase Plan (“ESPP”) using a Black-Scholes option-pricing model on the date of grant. The Black-Scholes option-pricing model requires the use of subjective assumptions including volatility, expected term, and risk-free rate. For awards that vest based on service conditions, the Company recognizes expense using the straight-line method less estimated forfeitures based on historical experience.

Net Loss Per Share

Basic net loss per share is calculated by dividing the net loss by the weighted average number of common shares that were outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share is calculated by dividing the net loss by the sum of the weighted-average number of dilutive common share equivalents outstanding for the period determined using the treasury stock method. Dilutive common share equivalents are comprised of warrants, potential awards granted pursuant to the ESPP, and options outstanding under the Company’s other equity incentive plans. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding due to the Company’s net loss position.

Potentially dilutive securities not included in the calculation of diluted net loss per share (because inclusion would be anti-dilutive) are as follows (in thousands, in common stock equivalent shares):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Warrants for common stock	990	990	990	990
Common stock options	2,932	2,042	2,623	2,042
ESPP	17	17	9	9
	3,939	3,049	3,622	3,041

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the current year presentation.

Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board ("FASB") issued a new credit loss standard that changes the impairment model for most financial assets and certain other instruments. The standard is effective for public business entities for annual periods beginning after December 15, 2019, and interim periods within those years. Early adoption is permitted for all entities for annual periods beginning after December 15, 2018, and interim periods within those years. The Company is in the process of assessing the impact of the adoption of the standard on its financial statements.

In March 2016, FASB issued an Accounting Standards Update on changing certain aspects of accounting for share-based payments to employees. The new guidance will require all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also will allow an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting, and to make a policy election to account for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is in the process of assessing the impact of the adoption of the standard on its financial statements.

In February 2016, FASB issued final guidance for lease accounting. The new guidance requires lessees to put most leases on their balance sheet but to recognize expenses on their income statement in a manner similar to today's accounting. The new guidance also eliminates today's real estate-specific provisions for all entities. The standard is effective for public business entities for annual periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted for all entities. The Company is in the process of assessing the impact of the adoption of the standard on its financial statements.

In April 2015, the FASB issued ASU No. 2015-03 amended requirements that require debt issuance costs, related to a recognized debt liability, to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, effective for the Company beginning January 1, 2016 and applied retroactively for all consolidated balance sheets presented. The Company applied the amended presentation requirements in the first quarter 2016, which resulted in the reclassification of $0.4 million of debt issuance costs in the Company's balance sheet from other long-term assets to long-term notes payable at December 31, 2015.

In May 2014, FASB and the International Accounting Standards Board issued a comprehensive new revenue recognition standard that will supersede existing revenue guidance under U.S. GAAP and International Financial Reporting Standards. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. This may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. On July 9, 2015, the FASB approved a one-year deferral of the effective date of the standard to December 15, 2017 and early application is permitted, but not before the original effective date of December 15, 2016. The Company is in the process of assessing the impact of the adoption of the standard on its financial statements.

3. Short-Term Investments

The Company invests in various securities, principally in debt instruments of financial institutions and corporations. The following represents a summary of the estimated fair value of short-term investments at June 30, 2016 and December 31, 2015 (in thousands):

At June 30, 2016	Maturity (in years)	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Available-for-sale investment securities:					
Commercial paper	Less than 1	$ 23,703	$ 4	$ (1)	$ 23,706
Trading securities:					
Mutual funds held for nonqualified deferred compensation plan participants		$ 346	$ 18	$ (2)	$ 362
Total		$ 24,049	$ 22	$ (3)	$ 24,068

At December 31, 2015	Maturity (in years)	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Available-for-sale investment securities:					
Commercial paper	Less than 1	$ 21,712	$ 23	$ —	$ 21,735
US Treasuries	Less than 1	2,035	—	(1)	$ 2,034
Government-sponsored enterprise securities	Less than 1	4,029	—	(2)	4,027
		$ 27,776	$ 23	$ (3)	$ 27,796
Trading securities:					
Mutual funds held for nonqualified deferred compensation plan participants		$ 224	$ 1	$ (3)	$ 222
Total		$ 28,000	$ 24	$ (6)	$ 28,018

4. Inventory

Inventory consisted of the following (in thousands):

	June 30, 2016	December 31, 2015
Raw materials	$12,071	$ 10,606
Work in process	4,595	3,394
Finished goods	5,026	3,543
Total	$21,692	$ 17,543

5. Fair Value Measurements

Authoritative guidance on fair value measurements defines fair value, establishes a consistent framework for measuring fair value, and expands disclosures for each major asset and liability category measured at fair value on either a recurring or a nonrecurring basis. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Observable inputs such as unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Unobservable inputs in which there is little or no market data and that are significant to the fair value of the assets or liabilities, which require the reporting entity to develop its own valuation techniques that require input assumptions.

The following table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands):

		Fair Value Measurements at June 30, 2016		
		(Level 1)	(Level 2)	(Level 3)
Assets				
Cash equivalents (1)	$13,639	$13,639	$—	$ —
Commercial paper	23,706	—	23,706	—
Mutual funds held for nonqualified deferred compensation plan participants (2)	362	362	—	—
Total assets	$37,707	$14,001	$23,706	$ —
Liabilities				
Deferred compensation (2)	$362	$362	$—	$ —
Total liabilities	$362	$362	$—	$ —

		Fair Value Measurements at December 31, 2015		
		(Level 1)	(Level 2)	(Level 3)
Assets				
Cash equivalents (1)	$23,402	$23,402	$—	$ —
Commercial paper	21,735	—	21,735	—
Mutual funds held for nonqualified deferred compensation plan participants (2)	222	222	—	—
US Treasuries	2,034	2,034	—	—
Government-sponsored enterprise securities	4,027	—	4,027	—
Total assets	$51,420	$25,658	$25,762	$ —
Liabilities				
Deferred compensation (2)	$222	$222	$—	$ —

Total liabilities	$222	$222	$—	$ —

(1) Cash equivalents included money market funds and commercial paper with a maturity of three months or less from the date of purchase.
(2) Deferred compensation plans are compensation plans directed by the Company and structured as a Rabbi Trust for certain executives and non-employee directors. The investment assets of the Rabbi Trust are valued using quoted market prices multiplied by the number of shares held in each trust account. The related deferred compensation liability represents the fair value of the investment assets.

The Company's Level 2 financial instruments are valued using market prices on less active markets with observable valuation inputs such as interest rates and yield curves. The Company obtains the fair value of Level 2 financial instruments from quoted market prices, calculated prices or quotes from third-party pricing services. The Company validates these prices through independent valuation testing and review of portfolio valuations provided by the Company's investment managers. There were no transfers between Level 1 and Level 2 securities during the six months ended June 30, 2016.

6. Term Loan Agreement

In January 2016, the Company entered into Amendment No. 3 to Term Loan Agreement with Capital Royalty Partners ("Third Amendment"), which was previously amended by Consent and Amendment Agreement, dated June 20, 2014, and Omnibus Amendment Agreement No. 2, dated February 23, 2015.

Under the Term Loan Agreement, the Company had aggregate borrowings outstanding of $30.2 million (such amount, the "First Tranche") as of December 31, 2015. Under the Third Amendment, the Company borrowed $15.0 million (such amount, the "Second Tranche") in January 2016, and the Third Amendment provides the Company with a one-time option to draw up to an additional $35.0 million in increments of $5.0 million on or before December 31, 2016 (such amount, to the extent drawn, the "Third Tranche").

The other principal terms of the Term Loan Agreement were not amended by the Third Amendment. Accordingly, interest continues to be payable, at the Company's option, (i) in cash at a rate of 11.5% per annum or (ii) at a rate of 9.5% of the 11.5% per annum in cash and 2.0% of the 11.5% per annum (the "PIK Loan") to be added to the principal of the loan and subject to accruing interest. Interest-only payments continue to be due quarterly on March 31, June 30, September 30 and December 31 of each year of the interest-only payment period, which ends on December 31, 2019. The principal balance continues to be due in full at the end of the term of the loan, which is March 31, 2020 (the "Maturity Date"). The Term Loan Agreement provides for prepayment fees in an amount equal to one percent (1.0%) of the outstanding balance of the loan if the loan is repaid prior to March 31, 2017, after which there is no prepayment fee. The term loan is collateralized by all assets of the Company. The principal financial covenants continue to require that the Company attain minimum annual revenues of $65.0 million in 2016, $80.0 million in 2017 and $95.0 million each year thereafter until the Maturity Date. At June 30, 2016, the Company was in compliance with all of the covenants in the Term Loan Agreement.

The Company had elected to pay interest in cash at a rate of 11.5% per annum through September 30, 2015. Beginning October 1, 2015, the Company elected to pay interest in cash at a rate of 9.5% per annum and to have 2.0% per annum added to the principal of the loan. As a result, $440,000 and $153,000 was added to the principal of the loan for the six months ended June 30, 2016 and the three months ended December 31, 2015, respectively. The Company had $45.6 million of aggregate borrowings outstanding under the Term Loan Agreement as of June 30, 2016.

Pursuant to the Third Amendment, the Company has agreed to pay, on the earlier of (i) the Maturity Date; (ii) the date that the loan under the Term Loan Agreement becomes due, and (iii) the date on which the Company makes a voluntary pre-payment of the loan, a financing fee equal to three percent (3.0%) of the sum of (x) the aggregate amount of the Second Tranche and Third Tranche drawn, and (y) any PIK Loans issued in relation to the Second Tranche and Third Tranche (collectively, the "Back End Financing Fee"). As of June 30, 2016 the Company had accrued $0.5 million for the Back End Financing Fee in other long-term liabilities and as contra-debt in notes payable--long-term on the accompanying balance sheet.

The Company treated this amendment as a modification. The present value of the future cash flows under the Third Amendment did not exceed the present value of the future cash flows under the previous terms by more than 10%. The Back End Financing Fee and the remaining balance of debt issuance costs and debt discount of the loan are amortized to interest expense over the remaining term of the Third Amendment using the effective interest method.

7. Stockholders' Equity

Public Offering

In the first quarter of 2015, the Company completed a public offering of 6,037,500 shares of its common stock at a public offering price of $11.50 per share. Net cash proceeds from the public offering were approximately $64.9 million, after deducting underwriting discounts, commissions and offering expenses paid by the Company.

Shares Reserved for Future Issuance

The following shares of the Company's common stock were reserved for future issuance at June 30, 2016:

Shares underlying outstanding warrants	990,031
Shares underlying outstanding stock options	6,774,815
Shares authorized for future equity award grants	2,058,291
Shares authorized for issuance as ESPP awards	520,420
	10,343,557

The Company issued 108,299 shares of its common stock upon the exercise of stock options and warrants during the six months ended June 30, 2016, and issued 260,091 shares of its common stock upon the exercise of stock options and warrants during the year ended December 31, 2015.

The ESPP enables eligible employees to purchase shares of the Company's common stock using their after tax payroll deductions, subject to certain conditions. The ESPP consists of a two-year offering period with four six-month purchase periods which begin in May and November of each year. There were 250,367 shares of the Company's common stock purchased under the ESPP during the six months ended June 30, 2016, and 302,171 shares of the Company's common stock purchased under the ESPP during the year ended December 31, 2015.

Stock-Based Compensation

The assumptions used in the Black-Scholes option-pricing model are as follows:

	Stock Option Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Weighted average grant date fair value (per share)	$4.36	$7.24	$3.79	$7.67
Risk-free interest rate	1.4 %	1.7 %	1.4 %	1.7 %
Expected dividend yield	0.0 %	0.0 %	0.0 %	0.0 %
Expected volatility	56.0%			