Cardiovascular Systems Inc
Form 10-Q
February 07, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 December 31, 2013
Commission File No. 000-52082

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

Delaware (State or other jurisdiction of incorporation or organization)	No. 41-1698056 (IRS Employer Identification No.)

651 Campus Drive
St. Paul, Minnesota 55112-3495
(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 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 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	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
The number of shares outstanding of the registrant's common stock as of January 31, 2014 was: Common Stock, $0.001 par value per share, 30,001,803 shares.

Table of Contents

Cardiovascular Systems, Inc.
Consolidated Financial Statements
Table of Contents

Table of Contents

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)

	December 31, 2013	June 30, 2013
ASSETS		
Current assets		
Cash and cash equivalents	$146,664	$67,897
Accounts receivable, net	15,918	14,730
Inventories	10,283	6,243
Prepaid expenses and other current assets	1,476	959
Total current assets	174,341	89,829
Property and equipment, net	3,088	2,999
Patents, net	3,505	3,219
Debt conversion option and other assets	70	850
Total assets	$181,004	$96,897
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	$5,050	$5,095
Accounts payable	8,511	7,230
Deferred grant incentive	151	156
Accrued expenses	11,092	9,932
Total current liabilities	24,804	22,413
Long-term liabilities		
Long-term debt, net of current maturities	—	7,472
Other liabilities	123	180
Total long-term liabilities	123	7,652
Total liabilities	24,927	30,065
Commitments and contingencies	—	—
Common stock, $0.001 par value; authorized 100,000,000 common shares at December 31, 2013 and June 30, 2013; issued and outstanding 29,779,548 at December 31, 2013 and 24,382,025 at June 30, 2013, respectively	30	24
Additional paid in capital	371,703	261,722
Common stock warrants	3,569	8,361
Accumulated deficit	(219,225)	(203,275)
Total stockholders' equity	156,077	66,832
Total liabilities and stockholders' equity	$181,004	$96,897

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

Table of Contents

Cardiovascular Systems, Inc.
Consolidated Statements of Operations
(Dollars in thousands, except per share and share amounts)
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Revenues	$32,337	$25,309	$62,103	$48,602
Cost of goods sold	7,313	5,958	14,177	11,212
Gross profit	25,024	19,351	47,926	37,390
Expenses				
Selling, general and administrative	27,468	20,418	52,839	40,441
Research and development	5,051	4,055	9,429	7,277
Total expenses	32,519	24,473	62,268	47,718
Loss from operations	(7,495)	(5,122)	(14,342)	(10,328)
Interest and other, net	(1,163)	(645)	(1,608)	(649)
Net loss and comprehensive loss	$(8,658)	$(5,767)	$(15,950)	$(10,977)
Net loss and comprehensive loss per common share:				
Basic and Diluted	$(0.32)	$(0.28)	$(0.61)	$(0.53)
Weighted average common shares used in computation:				
Basic and Diluted	27,177,952	20,699,222	25,964,660	20,548,113

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

Table of Contents

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

	Six Months Ended December 31, 2013	2012
Cash flows from operating activities		
Net loss	$(15,950)	$(10,977)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation of property and equipment	579	503
Amortization and write-off of patents	102	—
Provision for doubtful accounts	190	130
Amortization of (premium) discount on debt, net	137	(42)
Debt conversion and valuation of conversion options, net	716	(112)
Stock-based compensation	4,855	3,440
Changes in assets and liabilities		
Accounts receivable	(1,378)	494
Inventories	(4,040)	(100)
Prepaid expenses and other assets	(194)	581
Accounts payable	1,399	(799)
Accrued expenses and other liabilities	1,096	(405)
Net cash used in operations	(12,488)	(7,287)
Cash flows from investing activities		
Expenditures for property and equipment	(717)	(393)
Costs incurred in connection with patents	(385)	(391)
Net cash used in investing activities	(1,102)	(784)
Cash flows from financing activities		
Proceeds from employee stock purchase plan	1,291	761
Exercise of stock options and warrants	9,097	3,404
Proceeds from the issuance of common stock, net of issuance costs	84,369	—
Proceeds from line of credit	4,800	—
Payments on long-term debt	(7,200)	(2,400)
Net cash provided by (used in) financing activities	92,357	1,765
Net change in cash and cash equivalents	78,767	(6,306)
Cash and cash equivalents		
Beginning of period	67,897	35,529
End of period	$146,664	$29,223

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

Table of Contents

CARDIOVASCULAR SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(For the six months ended December 31, 2013 and 2012)
(Dollars in thousands, except per share and share amounts)
(Unaudited)

1. Business Overview

Company Description

Cardiovascular Systems, Inc. (the "Company") develops, manufactures and markets devices for the treatment of vascular diseases. The Company’s peripheral arterial disease products, the Stealth 360° PAD System, Diamondback 360° PAD System, and Predator 360° PAD System, are catheter-based platforms capable of treating a broad range of plaque types, including calcified plaque, in leg arteries both above and below the knee and address many of the limitations associated with existing treatment alternatives.

In October 2013, the Company received premarket approval (“PMA”) from the FDA to market the Diamondback 360® Coronary Orbital Atherectomy System (“OAS”) as a treatment for severely calcified coronary arteries. The Company began a controlled commercial launch of the Diamondback 360® Coronary OAS following receipt of PMA approval.

2. Summary of Significant Accounting Policies

Interim Financial Statements

The Company has 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 to state fairly the Company’s consolidated financial position, the results of its operations 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 Form 10-K filed by the Company with the SEC on September 11, 2013. 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.

Fair Value of Financial Instruments

The Company has adopted fair value guidance issued by the Financial Accounting Standards Board (“FASB”), which provides a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. The fair value guidance classifies inputs into the following hierarchy:

Level 1 Inputs — quoted prices in active markets for identical assets and liabilities
Level 2 Inputs — observable inputs other than quoted prices in active markets for identical assets and liabilities
Level 3 Inputs — unobservable inputs

The following table sets forth the fair value of the Company’s financial instruments that were measured on a recurring basis as of December 31, 2013. Assets are measured on a recurring basis if they are remeasured at least annually:

	Level 3 Conversion Option
Balance at June 30, 2013	$716
Conversion of convertible notes	(655)
Change in conversion option valuation	(61)
Balance at December 31, 2013	$—

Table of Contents

The fair value of the debt conversion option is related to the loan and security agreement with Partners for Growth III, L.P. (described in Note 4) and has been included as a component of debt conversion option and other assets on the balance sheet as of June 30, 2013. There is no balance for the debt conversion option asset at December 31, 2013 as all of the associated convertible debt was converted. The Monte Carlo option pricing model used to determine the value of the debt conversion option included various inputs including expected volatility, stock price simulations, and assessed behavior of the Company and Partners for Growth based on those simulations. Based upon these inputs, the Company considers the conversion option to be a Level 3 investment. Significant increases (decreases) in any of these inputs in isolation would result in a significantly higher (lower) fair value measurement.

As of December 31, 2013, the Company believes that the carrying amounts of its other financial instruments, including accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the short-term maturities of these instruments.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Stock-Based Compensation

The Company recognizes stock-based compensation expense in an amount equal to the fair value of share-based payments computed at the date of grant. The fair value of all stock option and restricted stock awards are expensed in the consolidated statements of operations ratably over the related vesting period.

Revenue Recognition

The Company sells the majority of its products via direct shipment to hospitals or clinics. The Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and collectability is reasonably assured. The Company records estimated sales returns, discounts and rebates as a reduction of net sales in the same period revenue is recognized. Costs related to products delivered are recognized in the period revenue is recognized. Cost of goods sold consists primarily of raw materials, direct labor, and manufacturing overhead.

3. Selected Consolidated Financial Statement Information

	December 31, 2013	June 30, 2013
Accounts Receivable		
Accounts receivable	$16,545	$15,188
Less: Allowance for doubtful accounts	(627)	(458)
	$15,918	$14,730

7

	December 31, 2013	June 30, 2013
Inventories		
Raw materials	$4,158	$2,477
Work in process	904	688
Finished goods	5,221	3,078
	$10,283	$6,243

	December 31, 2013	June 30, 2013
Accrued expenses		
Salaries and bonus	$3,298	$2,038
Commissions	4,915	4,956
Accrued vacation	2,438	2,151
Other	441	787
	$11,092	$9,932

4. Debt

Loan and Security Agreement with Silicon Valley Bank

On March 29, 2010, the Company entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement was amended on December 27, 2011 to increase the size of the facility, and subsequently amended on June 29, 2012 to modify financial covenants and reduce the interest rate and other fees, and on May 10, 2013 to modify financial covenants. The agreement, as amended, includes a $12,000 term loan and a $15,000 line of credit. The terms of each of these loans are as follows:

- The $12,000 term loan has an initial interest rate of 8.0%, which can be reduced to 7.0% based on the achievement of positive EBITDA for the trailing six month period. The term loan has a maturity of 36 months, with repayment terms that include interest only payments during the first six months, followed by 30 equal principal payments of $400 plus interest, and a final payment of $100 due at maturity. This term loan also includes an acceleration provision that requires the Company to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0% of the commitment amount, upon prepayment or the occurrence and continuance of an event of default. The balance outstanding on the term loan at December 31, 2013 and June 30, 2013 was $0 and $7,017, respectively, net of the unamortized discount associated with warrants issued to Silicon Valley Bank in connection with the loan.
- The $15,000 line of credit expires on June 30, 2014 and has a floating interest rate equal to the Wall Street Journal's prime rate, plus 1.25%, with an interest rate floor of 4.5%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on 85% of eligible accounts. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The line of credit is subject to non-use fees, annual fees, and cancellation fees. The balance outstanding on the line of credit at December 31, 2013 and June 30, 2013 was $4,800 and $0, respectively. During the quarter ended December 31, 2013, the Company paid the remaining balance on the term loan with funds from the line of credit.

Borrowings from Silicon Valley Bank are secured by all of the Company's assets. The borrowings are subject to prepayment penalties and financial covenants, including maintaining certain liquidity and fixed charge coverage ratios. Any non-compliance by the Company under the terms of debt arrangements could result in an event of default under the Silicon Valley Bank loan, which, if not cured, could result in the acceleration of this debt. The Company was in compliance with all financial covenants as of December 31, 2013.

Table of Contents

Loan and Security Agreement with Partners for Growth

On April 14, 2010, the Company entered into a loan and security agreement with Partners for Growth III, L.P. (PFG), as amended on August 23, 2011, December 27, 2011, June 30, 2012, and May 10, 2013. The amended agreement provides that PFG will make loans to the Company up to $5,000. The agreement has a maturity date of April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank's prime rate, and such interest is payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by the Company at any time in whole or in part. As of December 31, 2013, there are no loans outstanding that PFG has provided the Company.

At any time prior to the maturity date, PFG may at its option convert an outstanding loan into shares of the Company's common stock at the applicable conversion price, which in each case equals the ten-day volume weighted average price per share of the Company's common stock prior to the issuance date of each note. The Company may also effect at any time a mandatory conversion of amounts, subject to certain terms, conditions and limitations provided in the agreement, including a requirement that the ten-day volume weighted average price of the Company's common stock prior to the date of conversion is at least 15% greater than the conversion price. The Company may reduce the conversion price to a price that represents a 15% discount to the ten-day volume weighted average price of its common stock to satisfy this condition and effect a mandatory conversion. The Company recorded an expense of $61 for the six months ended December 31, 2013 related to the change in fair value of the conversion options on all outstanding loans. This amount is a component of interest and other, net on the accompanying statement of operations. There was no balance outstanding under the loan and security agreement at December 31, 2013 and the remaining net unamortized premium associated with the loan, a beneficial conversion feature, and other fees paid to the lender was recorded as a component of interest and other, net on the accompanying statement of operations.

For the six months ended December 31, 2013, PFG loan conversion activity was as follows:

Date of Conversion	Amount Converted	Shares Issued Upon Conversion
August 14, 2013	$500	32,679
October 15, 2013	$1,000	65,530
October 23, 2013	$1,500	96,586
November 13, 2013	$1,150	72,784
December 3, 2013	$850	53,518

The loans are secured by certain of the Company's assets, and the agreement contains customary covenants limiting the Company's ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on its stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of its business. In addition, the PFG loan and security agreement contains financial covenants requiring the Company to maintain certain liquidity and fixed charge coverage ratios. The Company was in compliance with all financial covenants at December 31, 2013. If the Company does not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

5. Equity Offering

On November 26, 2013, the Company, in a registered underwritten public offering, sold 3,000,000 shares of its common stock at $30.00 per share. Net proceeds to the Company, after deducting underwriting discounts, commissions, and expenses, were $84,369.

Table of Contents

6. Interest and Other, Net

Interest and other, net, includes the following:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Interest expense, net of premium amortization	$(564)	$(345)	$(845)	$(715)
Interest income	5	6	12	15
Change in fair value of conversion option	—	(276)	(61)	112
Net write-offs upon conversion (option and unamortized premium)	(574)	—	(655)	—
Other	(30)	(30)	(59)	(61)
Total	$(1,163)	$(645)	$(1,608)	$