Cardiovascular Systems Inc
Form 10-Q
November 04, 2013

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 September 30, 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 October 28, 2013 was: Common Stock, $0.001 par value per share, 25,702,393 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)

	September 30, 2013	June 30, 2013
ASSETS		
Current assets		
Cash and cash equivalents	$63,227	$67,897
Accounts receivable, net	15,271	14,730
Inventories	8,266	6,243
Prepaid expenses and other current assets	1,231	959
Total current assets	87,995	89,829
Property and equipment, net	3,022	2,999
Patents, net	3,418	3,219
Debt conversion option and other assets	685	850
Total assets	$95,120	$96,897
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt	$5,074	$5,095
Accounts payable	8,520	7,230
Deferred grant incentive	151	156
Accrued expenses	10,209	9,932
Total current liabilities	23,954	22,413
Long-term liabilities		
Long-term debt, net of current maturities	5,742	7,472
Other liabilities	153	180
Total long-term liabilities	5,895	7,652
Total liabilities	29,849	30,065
Commitments and contingencies		
Common stock, $0.001 par value; authorized 100,000,000 common shares at September 30, 2013 and June 30, 2013; issued and outstanding 25,220,534 at September 30, 2013 and 24,382,025 at June 30, 2013, respectively	25	24
Additional paid in capital	269,725	261,722
Common stock warrants	6,088	8,361
Accumulated deficit	(210,567)	(203,275)
Total stockholders' equity	65,271	66,832
Total liabilities and stockholders' equity	$95,120	$96,897

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 September 30,	
	2013	2012
Revenues	$29,766	$23,293
Cost of goods sold	6,864	5,254
Gross profit	22,902	18,039
Expenses		
Selling, general and administrative	25,371	20,023
Research and development	4,378	3,222
Total expenses	29,749	23,245
Loss from operations	(6,847)	(5,206)
Interest and other, net	(445)	(4)
Net loss and comprehensive loss	$(7,292)	$(5,210)
Net loss and comprehensive loss per common share:		
Basic and Diluted	$(0.29)	$(0.26)
Weighted average common shares used in computation:		
Basic and Diluted	24,751,368	20,397,004

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)

	Three Months Ended September 30, 2013	2012
Cash flows from operating activities		
Net loss	$(7,292)	$(5,210)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation of property and equipment	293	204
Amortization and write-off of patents	28	34
Provision for doubtful accounts	90	80
Amortization of (premium) discount on debt, net	(8)	(21)
Debt conversion and valuation of conversion options, net	142	(388)
Stock-based compensation	2,300	1,755
Changes in assets and liabilities		
Accounts receivable	(631)	97
Inventories	(2,023)	99
Prepaid expenses and other assets	11	401
Accounts payable	1,329	(156)
Accrued expenses and other liabilities	143	1,313
Net cash used in operations	(5,618)	(1,792)
Cash flows from investing activities		
Expenditures for property and equipment	(287)	(164)
Costs incurred in connection with patents	(124)	(160)
Net cash used in investing activities	(411)	(324)
Cash flows from financing activities		
Exercise of stock options and warrants	2,559	—
Payments on long-term debt	(1,200)	(1,200)
Net cash provided by (used in) financing activities	1,359	(1,200)
Net change in cash and cash equivalents	(4,670)	(3,316)
Cash and cash equivalents		
Beginning of period	67,897	35,529
End of period	$63,227	$32,213

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 three months ended ended September 30, 2013 and 2012)
(Dollars in thousands, except per share and share amounts)
(Unaudited)

1. Business Overview

Company Description

Cardiovascular Systems, Inc. was incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its reverse merger with Cardiovascular Systems, Inc., a Minnesota corporation incorporated in 1989 (“CSI-MN”), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the “Merger Agreement”). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly-owned subsidiary of Replidyne. At the effective time of the merger, Replidyne, Inc. changed its name to Cardiovascular Systems, Inc. (“CSI”) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation.

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

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The following table sets forth the fair value of the Company's financial instruments that were measured on a recurring basis as of September 30, 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	(81)
Change in conversion option valuation	(61)
Balance at September 30, 2013	$574

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. 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. The following assumptions were utilized in determining the fair value at September 30, 2013:

	September 30, 2013
Risk-free interest rate	0.30%
Contractual term	1.54 years
Expected volatility	51.61%

As of September 30, 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. The carrying amount of long-term debt approximates fair value based on interest rates currently available for debt with similar terms and maturities.

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

Inventories

Inventories are stated at the lower of cost or market with cost determined on a first-in, first-out ("FIFO") method of valuation. The establishment of inventory allowances for excess and obsolete inventories is based on estimated exposure on specific inventory items.

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At September 30, 2013 and June 30, 2013, respectively, inventories were comprised of the following:

	September 30, 2013	June 30, 2013
Inventories		
Raw materials	$3,146	$2,477
Work in process	739	688
Finished goods	4,381	3,078
	$8,266	$6,243

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 September 30, 2013 was $5,847 net of the unamortized discount associated with warrants issued to Silicon Valley Bank in connection with the loan. The unamortized discount associated with warrants and other fees paid to the lender are being amortized over the 36 month maturity period.
- 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. There was not an outstanding balance on the line of credit at September 30, 2013.

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. The Company was in compliance with all financial covenants as of September 30, 2013. 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.

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.

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As of September 30, 2013, PFG has provided the Company with the following four loans totaling $4,500 that are outstanding:

Date of Loan	Amount of Loan	Conversion Price
February 7, 2013	$1,000	$15.26
February 19, 2013	$1,500	$15.53
February 27, 2013	$1,500	$15.80
March 6, 2013	$500	$15.94

At any time prior to the maturity date, PFG may at its option convert any of the outstanding loans 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 three months ended September 30, 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. The balance outstanding under the loan and security agreement at September 30, 2013 was $4,719 including the net unamortized premium. The net unamortized premium associated with the loan, a beneficial conversion feature, and other fees paid to the lender is being amortized over the remaining maturity period.

For the three months ended September 30, 2013, PFG loan conversion activity was as follows:

Date of Conversion	Amount Converted	Shares Issued Upon Conversion
August 14, 2013	$500	32,679

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 September 30, 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.

As of September 30, 2013, debt maturities were as follows:

Nine months ended June 30, 2014	$3,850
2015	6,900
Total	$10,750
Less: Current Maturities	(5,074)
Long-Term Debt (excluding net unamortized premium)	$5,676
Add: Net Unamortized Premium	66
Long-term debt	$5,742

Subsequent to September 30, 2013, PFG converted the $1,000 loan dated February 7, 2013 for 65,530 shares of the Company's common stock at a conversion price of $15.26 and the $1,500 loan dated February 19, 2013 for 96,586 shares of the Company's common stock at a conversion price of $15.53.

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5. Interest and Other, Net

Interest and other, net, includes the following:

	Three Months Ended September 30,	
	2013	2012
Interest expense, net of premium amortization	$(281)	$(370)
Interest income	7	9
Change in fair value of conversion option	(61)	388
Net write-offs upon conversion (option and unamortized premium)	(81)	—
Other	(29)	(31)
Total	$(445)	$(4)

6. Stock Options and Restricted Stock Awards

The Company has a 2007 Equity Incentive Plan (the “2007 Plan”), which was assumed from CSI-MN, under which options to purchase common stock and restricted stock awards have been granted to employees, directors and consultants at exercise prices determined by the board of directors; and also in connection with the merger the Company assumed options and restricted stock awards granted by CSI-MN under its 1991 Stock Option Plan (the “1991 Plan”) and 2003 Stock Option Plan (the “2003 Plan”) (the 2007 Plan, the 1991 Plan and the 2003 Plan collectively, the “Plans”). The 1991 Plan and 2003 Plan permitted the granting of incentive stock options and nonqualified stock options. A total of 485,250 shares of common stock were originally reserved for issuance under the 1991 Plan, but with the approval of the 2003 Plan no additional options were granted under it. A total of 2,458,600 shares of common stock were originally reserved for issuance under the 2003 Plan, but with the approval of the 2007 Plan no additional options will be granted under it.

The 2007 Plan originally allowed for the granting of up to 1,941,000 shares of common stock as approved by the board of directors in the form of nonqualified or incentive stock options, restricted stock awards, restricted stock unit awards, performance share awards, performance unit awards or stock appreciation rights to officers, directors, consultants and employees of the Company. The Plan was amended in February 2009 to increase the number of authorized shares to 2,509,969. Generally, options or shares granted under the 2007 Plan expire ten years from the date of grant and vest over three years. The amended 2007 Plan includes a renewal provision whereby the number of shares shall automatically be increased on the first day of each fiscal year ending on July 1, 2017, by the lesser of (i) 970,500 shares, (ii) 5% of the outstanding common shares on such date, or (iii) a lesser amount determined by the board of directors. On July 1, 2013, the number of shares available for grant was increased by 475,000 under the 2007 Plan renewal provision, which was 1.9% of shares outstanding at June 30, 2013.

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. In addition, the Company has granted nonqualified stock options to a director outside of the Plans.

As of September 30, 2013, all outstanding options were fully vested. An employee's vested options must be exercised at or within 90 days of termination to avoid forfeiture.

Stock option activity for the three months ended September 30, 2013 is as follows:

	Number of Options(a)	Weighted Average Exercise Price
Options outstanding at June 30, 2013	1,739,663	$9.79
Options exercised	(82,889)	$9.52
Options outstanding at September 30, 2013	1,656,774	$9.81

(a) Includes the effect of options granted, exercised, forfeited or expired from the 1991 Plan, 2003 Plan, 2007 Plan, and options granted outside the stock option plans described above.

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The fair 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 restricted stock awards generally 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.

On September 4, 2013, the Company granted performance based restricted stock awards to certain executives. The performance based awards included grants of an aggregate of 53,566 shares that vest based upon achievement of certain thresholds measuring total shareholder return during periods within fiscal 2014 compared to a pre-determined peer group of companies, and grants of an aggregate of 53,566 shares that vest based upon achievement of certain thresholds measuring annual revenue growth during fiscal 2014 compared to a pre-determined peer group of companies.

On July 24, 2013, the Company also granted performance based restricted stock awards comprising of 16,964 shares to certain executives for over-attainment of fiscal 2013 total shareholder return measures compared to a pre-determined peer group of companies. On September 11, 2013, the Company also granted performance based restricted stock awards comprising of 16,964 shares to certain executives for over-attainment of fiscal 2013 annual revenue growth measures compared to a pre-determined peer group of companies. The related expense for the fiscal 2013 performance grants was recorded for the year ended June 30, 2013.

Restricted stock award activity for the three months ended September 30, 2013 is as follows:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards outstanding at June 30, 2013	1,430,130	$10.78
Restricted stock awards granted	437,237	$14.40
Restricted stock awards forfeited	(37,103)	$10.96
Restricted stock awards vested	(526,729)	$9.70
Restricted stock awards outstanding at September 30, 2013	1,303,535	$12.98

7. Common Stock Warrants

Common stock warrant activity for the three months ended September 30, 2013 is as follows:

	Number of Shares	Weighted Average Exercise Price
Common stock warrants outstanding at June 30, 2013	2,091,718	$8.96
Common stock warrants exercised	(424,237)	$9.15
Common stock warrants outstanding at September 30, 2013	1,667,481	$8.91

Of the 424,237 warrants exercised during the three months ended September