

AMEDICA Corp
Form 10-Q
May 13, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended March 31, 2016

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

Commission File Number 001-33624

Amedica Corporation

(Exact name of registrant as specified in its charter)

DELAWARE **84-1375299**
(State or other jurisdiction of **(IRS Employer**
incorporation or organization) **Identification No.)**

1885 West 2100 South, Salt Lake City, UT **84119**
(Address of principal executive offices) **(Zip Code)**

(801) 839-3500

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files); Yes No

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

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): []
Yes [X] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

13,236,071 shares of common stock, \$0.01 par value, were outstanding at May 13, 2016

Amedica Corporation

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Amedica Corporation**Condensed Consolidated Balance Sheets - Unaudited****(in thousands, except share and per share data)**

| | March 31, 2016 | December 31, 2015 |
|--|-------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$7,943 | \$11,485 |
| Trade accounts receivable, net of allowance of \$28 and \$49, respectively | 1,848 | 2,660 |
| Prepaid expenses and other current assets | 705 | 229 |
| Inventories, net | 8,492 | 9,131 |
| Total current assets | 18,988 | 23,505 |
| Property and equipment, net | 2,333 | 2,472 |
| Intangible assets, net | 3,562 | 3,687 |
| Goodwill | 6,163 | 6,163 |
| Other long-term assets | 35 | 35 |
| Total assets | \$31,081 | \$35,862 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$982 | \$643 |
| Accrued liabilities | 3,203 | 3,421 |
| Current portion of long-term debt | 14,785 | 16,365 |
| Total current liabilities | 18,970 | 20,429 |
| Deferred rent | 405 | 432 |
| Other long-term liabilities | 169 | 171 |
| Derivative liabilities | 604 | 598 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, \$0.01 par value; 250,000,000 shares authorized; 11,422,636 and 10,886,248 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively | 114 | 109 |
| Additional paid-in capital | 210,744 | 210,660 |
| Accumulated deficit | (199,925) | (196,537) |
| Total stockholders' equity | 10,933 | 14,232 |
| Total liabilities and stockholders' equity | \$31,081 | \$35,862 |

See accompanying notes.

Amedica Corporation**Condensed Consolidated Statements of Operations and Comprehensive Loss - Unaudited****(in thousands, except share and per share data)**

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2016 | 2015 |
| Product revenue | \$4,173 | \$4,743 |
| Costs of revenue | 893 | 1,522 |
| Gross profit | 3,280 | 3,221 |
| Operating expenses: | | |
| Research and development | 1,608 | 1,843 |
| General and administrative | 1,562 | 2,027 |
| Sales and marketing | 2,594 | 3,357 |
| Total operating expenses | 5,764 | 7,227 |
| Loss from operations | (2,484) | (4,006) |
| Other income (expense): | | |
| Interest expense | (900) | (1,100) |
| Loss on extinguishment of debt | - | (79) |
| Change in fair value of derivative liabilities | (11) | (177) |
| Loss on extinguishment of derivative liabilities | - | (16) |
| Other expense | 7 | (3) |
| Total other income (expense) | (904) | (1,375) |
| Net loss before income taxes | (3,388) | (5,381) |
| Provision for income taxes | - | - |
| Total comprehensive loss | \$(3,388) | \$(5,381) |
| Net loss per share attributable to common stockholders: | | |
| Basic and diluted | \$(0.30) | \$(3.00) |
| Weighted average common shares outstanding: | | |
| Basic and diluted | 11,193,250 | 1,795,296 |

See accompanying notes.

Amedica Corporation**Condensed Consolidated Statements of Cash Flows - Unaudited****(in thousands)**

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2016 | 2015 |
| Cash flow from operating activities | | |
| Net loss | \$(3,388) | \$(5,381) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation expense | 389 | 428 |
| Amortization of intangible assets | 125 | 125 |
| Amortization of lease incentive for tenant improvements | 5 | 5 |
| Non cash interest expense | 405 | 551 |
| Loss on extinguishment of debt | - | 79 |
| Stock based compensation | 88 | 592 |
| Change in fair value of derivative liabilities | 6 | 177 |
| Loss on extinguishment of derivative liabilities | - | 16 |
| (Gain) loss on disposal of equipment | (4) | 3 |
| Provision for inventory reserve | 373 | 326 |
| Bad debt recovery | - | (20) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | 813 | (35) |
| Prepaid expenses and other current assets | (476) | (330) |
| Inventories | 263 | 293 |
| Accounts payable and accrued liabilities | (64) | 200 |
| Net cash used in operating activities | \$(1,465) | \$(2,971) |
| Cash flows from investing activities | | |
| Purchase of property and equipment | (259) | (277) |
| Proceeds from sale of property and equipment | 16 | 3 |
| Net cash used in investing activities | \$(243) | \$(274) |
| Cash flows from financing activities | | |
| Payments on long-term debt | (1,834) | - |
| Purchase of treasury stock | - | (120) |
| Net cash used in financing activities | \$(1,834) | \$(120) |
| Net decrease in cash and cash equivalents | (3,542) | (3,365) |
| Cash and cash equivalents at beginning of period | 11,485 | 18,247 |
| Cash and cash equivalents at end of period | \$7,943 | \$14,882 |
| Noncash investing and financing activities | | |
| Debt converted to common stock | \$- | \$202 |
| Common stock issued for cashless exercise of warrant derivative liabilities | \$- | \$739 |
| Supplemental cash flow information | | |
| Cash paid for interest | \$507 | \$548 |

See accompanying notes.

AMEDICA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization

Amedica Corporation (“Amedica” or “the Company”) was incorporated in the state of Delaware on December 10, 1996. Amedica is a commercial-stage biomaterials company focused on using its silicon nitride technology platform to develop, manufacture, and commercialize a broad range of medical devices. The Company believes it is the first and only manufacturer to use silicon nitride in medical applications. The Company acquired US Spine, Inc. (“US Spine”), a Delaware spinal products corporation with operations in Florida, on September 20, 2010. The Company’s products are sold primarily in the United States.

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated audited financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 23, 2016. The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016. The Company’s significant accounting policies are set forth in Note 1 to the consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2015.

In accordance with the adoption of Accounting Standards Update (“ASU”) 2015-03, the Company’s debt issuance costs have been reclassified to be presented in the Condensed Consolidated Balance Sheets as a direct reduction from the debt liability rather than as an asset.

The following is a reconciliation of the effect of these reclassifications on the Company's Condensed Consolidated Balance Sheet at December 31, 2015 (in thousands):

| | December 31, 2015 | | |
|---|-------------------|-------------|---------------|
| | As Reported | Adjustments | As Revised |
| Assets: | | | |
| Prepaid expenses and other current assets | \$821 | \$ (592) | \$ 229 |
| Liabilities: | | | |
| Current portion of long-term debt | 16,957 | (592) | 16,365 |

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("U.S. 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 revenue and expenses during the period. Actual results could differ from those estimates. Some of the more significant estimates relate to inventory, stock-based compensation, long-lived and intangible assets and the liability for preferred stock and common stock warrants.

Liquidity and Capital Resources

For the three months ended March 31, 2016 and 2015, the Company incurred a net loss of \$3.4 million and \$5.4 million, respectively, and used cash in operations of \$1.5 million and \$3 million, respectively. The Company had an accumulated deficit of \$199.9 million and \$196.5 million at March 31, 2016 and December 31, 2015, respectively. To date, the Company's operations have been principally financed from proceeds from the issuance of preferred and common stock, convertible debt and bank debt and, to a lesser extent, cash generated from product sales. It is anticipated that the Company will continue to generate operating losses and use cash in operations through 2016.

As discussed further in Note 7, the Company has entered into a term loan with Hercules Technology Growth Capital, Inc. (“Hercules Technology”), as administrative and collateral agent for the lenders thereunder and as lender, and Hercules Technology III, LP, (“HT III” and, together with Hercules Technology, “Hercules”) as lender (the “Hercules Term Loan”). The Hercules Term Loan has a liquidity covenant that requires the Company to maintain a cash balance of not less than \$7.0 million at March 31, 2016. At March 31, 2016, the Company’s cash balance was approximately \$7.9 million. The Company anticipates that it will need to refinance the note or obtain additional funding early in the third quarter of 2016 to maintain compliance through 2016 with the liquidity covenant related to the Hercules Term Loan. However, if the Company is unable to refinance the note or access additional funds prior to becoming non-compliant with the financial and liquidity covenants related to the Hercules Term Loan, the entire remaining balance of the debt under the Hercules Term Loan could become immediately due and payable at the option of the lender. Although the Company is seeking to refinance the note or obtain additional financing, additional funding may not be available to the Company on favorable or acceptable terms, or at all. Any additional equity financing, if available to the Company, will most likely be dilutive to its current stockholders, and debt financing, if available, may involve more restrictive covenants. The Company’s ability to access capital when needed is not assured and, if not achieved on a timely basis, will materially harm its business, financial condition and results of operations. These uncertainties create substantial doubt about the Company’s ability to continue as a going concern. No adjustment has been made to our financial statements as a result of this uncertainty.

See Note 11. Subsequent Events for further discussion with respect to the assignment of \$3.0 million of the principal balance of the Hercules Term Loan to Riverside Merchant Partners, LLC (“Riverside”) and the subsequent agreement between the Company and Riverside to exchange the \$3.0 million of the Hercules Term Loan held by Riverside for subordinated convertible promissory notes in the aggregate principal amount of \$3.0 million.

Significant Accounting Policies

There have been no significant changes to the Company’s significant accounting policies as described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

New Accounting Pronouncements

In March 2016 the Financial Accounting Standards Board (“FASB”) updated the accounting guidance related to stock compensation. This update simplifies the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company is still evaluating the impact that this standard will have on its consolidated financial statements.

In February 2016, the FASB updated the accounting guidance related to leases as part of a joint project with the International Accounting Standards Board (“IASB”) to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the new guidance, a lessee will be required to recognize assets and liabilities for capital and operating leases with lease terms of more than 12 months. Additionally, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the potential impact this new standard may have on its financial statements.

In August 2014, the FASB updated the accounting guidance related to disclosure of uncertainties about an entity’s ability to continue as a going concern. The new standard provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. It requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern. The new standard is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The impact on the Company’s financial statements of adopting the new standard is currently being assessed by management.

In May 2014, the FASB updated the accounting guidance related to revenue from contracts with customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle is that a company should recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. The standard defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, and shall be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

2. Basic and Diluted Net Loss per Common Share

Basic net loss per share is calculated by dividing the net loss by the weighted-average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share is calculated by dividing the net loss by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. Dilutive common stock equivalents are comprised of warrants for the purchase of common stock, convertible notes, stock options and unvested restricted stock units. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding because their effect would have been anti-dilutive due to the Company reporting a net loss. The Company had potentially dilutive securities representing approximately 800,000 and 2.9 million shares of common stock at March 31, 2016 and 2015, respectively.

3. Inventories

The components of inventory were as follows (in thousands):

| | March 31, 2016 | December 31, 2015 |
|-----------------|----------------------|----------------------|
| Raw materials | \$788 | \$ 819 |
| WIP | 229 | 235 |
| Finished Goods | 7,475 | 8,077 |
| Total inventory | \$8,492 | \$ 9,131 |

Finished goods include consigned inventory in the amounts of approximately \$3.4 million and \$3.8 million as of March 31, 2016 and December 31, 2015, respectively.

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

| March 31, 2016 | December 31, 2015 |
|-------------------|----------------------|
|-------------------|----------------------|

| | | |
|---------------------------------------|---------|----------|
| Customer relationships | \$3,990 | \$ 3,990 |
| Developed technology | 4,685 | 4,685 |
| Other patents and patent applications | 562 | 562 |
| Trademarks | 350 | 350 |
| Total intangibles | 9,587 | 9,587 |
| Less accumulated amortization | (6,025) | (5,900) |
| Total intangibles net of amortization | \$3,562 | \$ 3,687 |

Based on the recorded intangibles at March 31, 2016, the estimated amortization expense is expected to be \$375,000 during the remainder of 2016 and approximately \$501,000 per year through 2020 and \$834,000 thereafter.

5. Fair Value Measurements

Financial Instruments Measured and Recorded at Fair Value on a Recurring Basis

The Company measures and records certain financial instruments at fair value on a recurring basis. Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, under a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1 - quoted market prices for identical assets or liabilities in active markets.

Level 2 - observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3 - unobservable inputs reflecting management's assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

The Company classifies assets and liabilities measured at fair value in their entirety based on the lowest level of input that is significant to their fair value measurement. No financial assets were measured on a recurring basis at March 31, 2016 and December 31, 2015. The following tables set forth the financial liabilities measured at fair value on a recurring basis by level within the fair value hierarchy at March 31, 2016 and December 31, 2015:

| Description | Fair Value Measurements at March 31, 2016 | | | Total |
|-----------------------|---|---------|---------|--------|
| | Level 1 | Level 2 | Level 3 | |
| | Derivative liability | | | |
| Common stock warrants | \$- | \$ - | \$ 604 | \$ 604 |

| Description | Fair Value Measurements at December 31, 2015 | | | Total |
|-----------------------|--|---------|---------|--------|
| | Level 1 | Level 2 | Level 3 | |
| | Derivative liability | | | |
| Common stock warrants | \$- | \$ - | \$ 598 | \$ 598 |

The Company did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2016 and 2015. The following table presents a reconciliation of the derivative liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three months ended March 31, 2016 and 2015:

| | Common Stock Warrants | Preferred Stock Warrants | Conversion Feature of Notes | Total Derivative Liability |
|--|-----------------------|--------------------------|-----------------------------|----------------------------|
| Balance at December 31, 2014 | \$(11,358) | \$ - | \$ (2,612) | \$(13,970) |
| Decrease in liability due to debt conversions | - | - | 179 | 179 |
| Decrease in liability due to warrants being exercised | 723 | - | - | 723 |
| Change in fair value | 435 | - | (612) | (177) |
| Balance at March 31, 2015 | \$(10,200) | \$ - | \$ (3,045) | \$(13,245) |
| Balance at December 31, 2015 | \$(598) | \$ - | \$ - | \$(598) |
| Increase in fair value included in earnings, as other income | (6) | - | - | (6) |
| Balance at March 31, 2016 | \$(604) | \$ - | \$ - | \$(604) |

Common Stock Warrants

The Company has issued certain warrants to purchase shares of common stock, which are considered mark-to-market liabilities and are re-measured to fair value at each reporting period in accordance with accounting guidance.

The assumptions used in estimating the common stock warrant liability at March 31, 2016 and December 31, 2015 were as follows:

| | March 31,2016 | December 31, 2015 |
|---|------------------|----------------------|
| Weighted-average risk free interest rate | 1.06% | 1.71% |
| Weighted-average expected life (in years) | 3.55 | 3.7 |
| Expected dividend yield | 0% | 0% |
| Weighted average expected volatility | 137% | 119% |

Other Financial Instruments

The Company's recorded values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values based on their short-term nature. The recorded value of notes payable approximates the fair value as the interest rate approximates market interest rates.

6. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

| | March 31, 2016 | December 31, 2015 |
|------------------------------|----------------------|----------------------|
| Commissions | \$563 | \$ 867 |
| Payroll and related expenses | 359 | 683 |
| Royalties | 478 | 515 |
| Interest payable | 237 | 222 |
| Final loan payment fees | 922 | 783 |
| Other | 644 | 351 |
| Total accrued liabilities | \$3,203 | \$ 3,421 |

7. Debt

Hercules Term Loan

On June 30, 2014, the Company entered into a Loan and Security Agreement with Hercules which provided the Company with a \$20 million term loan. The Hercules Term Loan matures on January 1, 2018. The Hercules Term Loan included a \$200,000 closing fee, which was paid to Hercules on the closing date of the loan. The closing fee was recorded as a debt discount and is being amortized to interest expense over the life of the loan. The Hercules Term Loan also includes a non-refundable final payment fee of \$1.7 million. The final payment fee is being accrued and recorded to interest expense over the life of the loan. The Hercules Term Loan bears interest at the rate of the greater of either (i) the prime rate plus 9.2%, and (ii) 12.5%, and was 12.7% at March 31, 2016. Interest accrues from the closing date of the loan and interest payments are due monthly. Principal payments commenced August 1, 2015 and are to be made in 30 equal installments of approximately \$700,000, with the remainder due at maturity. The Company's obligations to Hercules are secured by a first priority security interest in substantially all of its assets, including intellectual property. The Hercules Term Loan contains certain covenants related to restrictions on payments to certain Company affiliates and financial reporting requirements.

On September 8, 2015, the Company entered into a Consent and First Amendment to Loan and Security Agreement (the "Amendment") with Hercules. The Amendment modified the liquidity covenant to reduce the minimum cash balance required by \$500,000 for every \$1.0 million paid in principal to a minimum of \$2.5 million. The minimum cash and cash equivalents balance required to maintain compliance with the minimum liquidity covenant at March 31, 2016 was \$7.0 million. Although the Company was in compliance with the liquidity covenant at March 31, 2016, the

Company anticipates that it will be non-compliant with the liquidity covenant early in the third quarter of 2016 if additional financing is not obtained or the loan is not restructured, and has therefore classified the entire obligation as a current liability.

See Note 11. Subsequent Events for further discussion with respect to the assignment of \$3.0 million of the principal balance of the Hercules Term Loan to Riverside Merchant Partners, LLC (“Riverside”) and the subsequent agreement between the Company and Riverside to exchange the \$3.0 million of the Hercules Term Loan held by Riverside for subordinated convertible promissory notes in the aggregate principal amount of \$3.0 million.

Magna Note

In August 2014, the Company entered into a Securities Purchase Agreement with Magna pursuant to which the Company sold to Magna an unsecured promissory note with an aggregate principal amount of \$3.5 million (the “Magna Note”). The outstanding principal amount of the Magna Note was \$763,000 at March 31, 2016. The Magna Note matures on August 11, 2016, and accrues interest at an annual rate of 6.0%.

Outstanding long-term debt consisted of the following (in thousands):

| | March 31, 2016 | | | December 31, 2015 | | |
|-----------------------|--------------------------|--|---------------------------|--------------------------|--|---------------------------|
| | Outstanding Principal | Unamortized Discount and Debt Issuance Costs | Net Carrying Amount | Outstanding Principal | Unamortized Discount and Debt Issuance Costs | Net Carrying Amount |
| Hercules Term Loan | 15,218 | (1,186) | 14,032 | 17,051 | (1,420) | 15,631 |
| Magna Note | 763 | (10) | 753 | 763 | (29) | 734 |
| Total debt | 15,981 | (1,196) | 14,785 | 17,814 | (1,449) | 16,365 |
| Less: Current portion | (15,981) | 1,196 | (14,785) | (17,814) | 1,449 | (16,365) |
| Long-term debt | \$- | \$ - | \$- | \$- | \$ - | \$- |

The following summarizes by year the future principal payments as of March 31, 2016 (in thousands):

| Years Ending December 31, | Hercules Term Loan | Magna Note | Total |
|---------------------------------|--------------------------|---------------|----------|
| 2016 | \$5,787 | \$ 763 | \$6,550 |
| 2017 | 8,643 | - | 8,643 |
| 2018 | 788 | - | 788 |
| Total future principal payments | \$15,218 | \$ 763 | \$15,981 |

8. Equity

536,388 shares of common stock were issued upon the cashless exercise of 1,137,365 Series A warrants issued in September 2015. The remaining number of Series A warrants was 100,000 at March 31, 2016.

9. Stock-Based Compensation

Option and Equity Plans

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In January 2016, the aggregate number of shares issuable under the 2012 Employee, Director and Consultant Equity Incentive Plan (the “2012 Plan”) was increased by 37,879 to 342,425, in accordance with the 2012 plan.

The total number of shares available for grant under the 2012 Plan at March 31, 2016 was 121,248.

Stock Options

A summary of the Company’s stock option activity for the three months ended March 31, 2016 was as follows:

| | Options | Weighted-Average Exercise Price |
|---|---------|------------------------------------|
| Outstanding at December 31, 2015 | 112,373 | \$ 41.53 |
| Granted | 23,004 | \$ 1.69 |
| Expired | 13,702 | \$ 24.17 |
| Outstanding at March 31, 2016 | 121,675 | \$ 35.95 |
| Exercisable at March 31, 2016 | 74,859 | \$ 60.65 |
| Vested and expected to vest at March 31, 2016 | 119,112 | \$ 36.50 |

The Company estimates the fair value of each stock option on the grant date using the Black-Scholes-Merton valuation model, which requires several estimates including an estimate of the fair value of the underlying common stock on grant date. The expected volatility was based on an average of the historical volatility of a peer group of similar companies. The expected term was calculated utilizing the simplified method. The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The following weighted average assumptions were used in the calculation to estimate the fair value of options granted to employees during the three months ended March 31, 2016 and 2015:

| | Three Months Ended March 31, | |
|---|------------------------------------|-------|
| | 2016 | 2015 |
| Weighted-average risk-free interest rate | 1.86% | 1.62% |
| Weighted-average expected life (in years) | 6.3 | 6.3 |
| Expected dividend yield | 0% | 0% |
| Weighted-average expected volatility | 65% | 46% |

Summary of Stock-Based Compensation Expense

Total stock-based compensation expense included in the condensed consolidated statements of operations and comprehensive loss was allocated as follows (in thousands):

| | Three Months Ended March 31, | |
|--|---------------------------------------|-------|
| | 2016 | 2015 |
| Cost of revenue | \$4 | \$29 |
| Research and development | 29 | 122 |
| General and administrative | 40 | 328 |
| Selling and marketing | 15 | 142 |
| Capitalized into inventory | 2 | 39 |
| Total stock-based compensation expense | \$90 | \$660 |

Unrecognized stock-based compensation at March 31, 2016 was as follows (in thousands):

| | |
|-----------------------------|---------------------|
| Unrecognized Stock-Based | Weighted Average |
|-----------------------------|---------------------|

| Compensation | Remaining Period of Recognition (in years) |
|----------------------|---|
| Stock options \$ 435 | 1.7 |

10. Commitments and Contingencies

On April 1, 2016, Hampshire MedTech Partners II, GP (“Hampshire GP”) filed suit against the Company in the Travis County, Texas 200th Judicial District Court relating to a Warrant to Purchase Shares of Common Stock issued to Hampshire MedTech Partners II, LP (“Hampshire LP”) on November 6, 2014 (the “Warrant”). Hampshire GP alleges that as a result of a subsequent financing the Company breached the anti-dilution provision of the Warrant by failing to increase the number of shares subject to the Warrant as well as failing to reduce the exercise price of the Warrant. Hampshire GP seeks damages in excess of \$1,000,000. The Company has not yet answered Hampshire GP’s complaint and intends to vigorously defend itself in this suit.

From time to time, the Company is subject to other various claims and legal proceedings covering matters that arise in the ordinary course of its business activities. Management believes any liability that may ultimately result from the resolution of these matters will not have a material adverse effect on the Company’s consolidated financial position, operating results or cash flows.

11. Subsequent Events

Hercules and Riverside Debt Assignment

On April 4, 2016, the Company entered into an Assignment and Second Amendment to Loan and Security Agreement (the “Assignment Agreement”) with Riverside Merchant Partners, LLC (“Riverside”), and Hercules, pursuant to which Hercules sold \$1.0 million of the principal amount outstanding under the Hercules Term Loan, as amended to Riverside. In addition, pursuant to the terms of the Assignment Agreement, Riverside acquired an option to purchase an additional \$2.0 million of the principal amount outstanding under the Hercules Term Loan from Hercules. On April 18, 2016, Riverside purchased an additional \$1.0 million of the principal amount of the Hercules Term Loan and on April 27, 2016, Riverside purchased an additional \$1.0 million of the principal amount of the Hercules Term Loan from Hercules.

Riverside Debt Exchange

On April 4, 2016, the Company entered into an exchange agreement (the “Exchange Agreement”) with Riverside, pursuant to which the Company agreed to exchange \$1.0 million of the principal amount outstanding under the Hercules Term Loan held by Riverside for a subordinated convertible promissory note in the principal amount of \$1.0 million (the “First Exchange Note”) and a warrant to purchase 100,000 shares of common stock of the Company at a fixed exercise price of \$1.62 per share (the “First Exchange Warrant”) (the “Exchange”). In addition, pursuant to the terms and conditions of the Exchange Agreement, the Company and Riverside had the option to exchange an additional \$2.0 million of the principal amount of the Hercules Term Loan for an additional subordinated convertible promissory note in the principal amount of up to \$2.0 million and an additional warrant to purchase 100,000 shares of common stock (the “Second Exchange Warrant”). On April 18, 2016, the Company and Riverside exercised their option to exchange an additional \$1.0 million of the principal amount of the Hercules Term Loan for an additional subordinated convertible promissory note in the principal amount of \$1.0 million (the “Second Exchange Note”). Additionally, on April 27, 2016, the Company and Riverside exercised their option to exchange an additional \$1.0 million of the principal amount of the Term Loan for an additional subordinated convertible promissory note in the principal amount of \$1.0 million (the “Third Exchange Note”) and an additional warrant to purchase 100,000 shares of the Company’s common stock at a fixed exercise price of \$1.66 per share. The First Exchange Note, the Second Exchange Note and the Third Exchange Note are collectively referred to herein as the “Exchange Notes.”

All principal accrued under the Exchange Notes is convertible into shares of common stock at the election of the Holder at any time at a fixed conversion price of \$1.43 per share (the "Conversion Price"). All principal outstanding under each of the Exchange Notes will be due on April 3, 2018 (the "Maturity Date"). Each of the Exchange Notes bears interest at a rate of 6% per annum, with the interest that would accrue on the initial principal amount of the Exchange Notes during the first 12 months being guaranteed and deemed earned as of the date of issuance. Prior to the Maturity Date, all interest accrued under the Exchange Notes is payable in cash or, if certain conditions are met, payable in shares of common stock at the Company's option, at a conversion price of \$1.34 per share.

Pursuant to the terms of the Third Exchange Note, since the volume-weighted average price of the Company's common stock was less than the Conversion Price on May 6, 2016, the Company issued an additional 140,000 shares of common stock (the "True-Up Shares") to Riverside.

As of May 13, 2016, the entire principal amount of the First and Second Exchange Notes, \$200,000 of the Third Exchange Note, and the interest related to the First, Second, and Third Exchange Notes has been converted into 1,672,788 shares of common stock leaving the total principal balance outstanding under the Exchange Notes at \$800,000.

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 in conjunction with our consolidated financial statements for the year ended December 31, 2015 and the notes thereto, along with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2015, filed separately with the U.S. Securities and Exchange Commission. This discussion and analysis contains forward-looking statements based upon current beliefs, plans, expectations, intentions and projections that involve risks, uncertainties and assumptions, such as statements regarding our plans, objectives, expectations, intentions and projections. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of several factors, including those set forth under the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2015, and any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q.

Overview

We are a commercial biomaterial company focused on using our silicon nitride ceramic technology platform to develop, manufacture and sell a broad range of medical devices. We currently market spinal fusion products made

with our silicon nitride biomaterial technology and are developing a new generation of wear- and corrosion-resistant implant components for hip and knee arthroplasty also manufactured from our silicon nitride biomaterial. We believe our silicon nitride technology platform enables us to offer new and transformative products in the orthopedic and other medical device markets. We believe we are the first and only company to use silicon nitride in medical applications. More than 25,000 of our silicon nitride spine products have been implanted in patients.

Biomaterials come in an array of synthetic or natural materials available in a variety of forms that are used in virtually every medical specialty. We believe our silicon nitride biomaterial has superior characteristics compared to commonly used biomaterials in the markets we are targeting, including polyetheretherketone (“PEEK”), which is the most common biomaterial used for interbody spinal fusion products. Specifically, we believe our silicon nitride has the following key attributes: promotion of bone growth; antibacterial properties; superior biocompatibility; hardness, strength and resistance to fracture; resistance to wear; non-corrosive; and superior diagnostic imaging compatibility.

We currently market our Valeo™ family of silicon nitride interbody spinal fusion devices in the United States, Europe and Brazil for use in the cervical and thoracolumbar areas of the spine. We believe our Valeo devices have a number of advantages over existing products due to silicon nitride’s key characteristics, resulting in faster and more effective fusion and reduced risk of infection.

In addition to our silicon nitride-based spinal fusion products, we market a line of non-silicon nitride spinal surgery products which allows us to provide surgeons and hospitals with a more complete solution for spinal procedures. These additional products are complementary to our fusion products and are designed for the treatment of deformity and degenerative spinal procedures. Although our non-silicon nitride products have accounted for approximately 46% and 44% of our product revenues for the quarters ended March 31, 2016 and 2015, respectively, we believe the continued promotion and potential for adoption of our silicon nitride products and product candidates, if approved, provides us the greatest opportunity to grow our business in new and existing markets and achieve our goal to become a leading biomaterial company.

In addition to the markets into which we directly sell our products, we are utilizing our silicon nitride technology platform to expand our current penetration in the spinal fusion market through original equipment manufacturer (“OEM”) and private label partnerships. We also expect to do the same in other markets such as total hip and knee joint replacements, dental, extremities, trauma, and sports medicine. We believe our biomaterial expertise, strong intellectual property, and formulaic manufacturing process will allow us to transition currently available medical device products made of inferior biomaterials and manufacture them using our proprietary silicon nitride formulation and technology platform to improve their characteristics. We believe the OEM and private label partnerships we will continue to develop will lead to an accelerated adoption of silicon nitride for medical applications and offer the Company incremental revenue at improved operating margins as compared to our existing distributor spine sales.

We are also incorporating our silicon nitride technology into components for use in total hip and knee replacement product candidates that we plan on developing in collaboration with a strategic partner. We believe that our silicon nitride total hip and knee product candidates will provide competitive advantages over current products made with traditional biomaterials. We also believe our silicon nitride technology platform can be used for developing products in other markets and have developed prototypes for use in the dental, sports medicine, extremities, and trauma markets. As a result of some of the key characteristics of our silicon nitride, we also believe our coating technology may be used to enhance our metal products as well as commercially available metal spinal fusion, joint replacement and other medical products.

We operate a 30,000 square foot manufacturing facility located at our corporate headquarters in Salt Lake City, Utah, and we are the only vertically integrated silicon nitride medical device manufacturer in the world. We market and sell our products to surgeons and hospitals in the United States and select markets in Europe and South America through an established network of more than 50 independent sales distributors who are managed by our experienced in-house sales and marketing management team.

Recent Developments

Hercules and Riverside Debt Assignment

In April 2016, we entered into an Assignment Agreement with Riverside, and Hercules, pursuant to which Hercules sold \$3.0 million of the principal amount outstanding under the Hercules Term Loan to Riverside. For a more detailed description of the Assignment Agreement refer to Note 11 Subsequent Events in the consolidated financial statements of this Report.

Riverside Debt Exchange

In April 2016, we entered into an exchange agreement with Riverside, which resulted in the exchange of \$3.0 million of the principal amount outstanding under the Hercules Term Loan held by Riverside for three subordinated convertible promissory notes each in the principal amount of \$1.0 million. Pursuant to the terms and conditions of the exchange we offered a warrant to purchase 100,000 shares of the Company's common stock at a fixed exercise price of \$1.62 per share and a warrant to purchase an additional 100,000 shares of the Company's common stock at a fixed exercise price of \$1.66 per share.

All principal accrued under the Exchange Notes is convertible into shares of the Company's common stock at the election of the Holder at any time at a fixed conversion price of \$1.43 per share. All principal outstanding under each of the Exchange Notes will be due on March 3, 2018. Each of the Exchange Notes bears interest at a rate of 6% per annum, with the interest that would accrue on the initial principal amount of the Exchange Notes during the first 12 months being guaranteed and deemed earned as of the date of issuance. Prior to the Maturity Date, all interest accrued under the Exchange Notes is payable in cash or, if certain conditions are met, payable in shares of common stock at the Company's option, at a conversion price of \$1.34 per share.

Pursuant to the terms of the Third Exchange Note, since the volume-weighted average price of the Company's common stock was less than the Conversion Price on May 6, 2016, the Company issued an additional 140,000 shares of common stock (the "True-Up Shares") to Riverside.

Each of the First and Second Exchange Warrants will be exercisable commencing on the six month and one day anniversary of the date of issuance and will remain exercisable until the close of business on the five year anniversary of the date of issuance, but not thereafter. If the shares underlying the Exchange Warrants are not registered for resale with the Securities and Exchange Commission, the Exchange Warrants will be exercisable on a cashless basis.

As of May 13, 2016, the entire principal amount of the First and Second Exchange Notes, \$0.2 million of the Third Exchange Note, and the interest related to the First, Second, and Third Exchange Notes has been converted into 1,672,788 shares of common stock leaving the total principal balance outstanding under the Exchange Notes at \$0.8 million.

For a more detailed description of the Riverside Debt Exchange refer to Note 11 Subsequent Events in the consolidated financial statements of this Report.

Components of our Results of Operations

We manage our business within one reportable segment, which is consistent with how our management reviews our business, makes investment and resource allocation decisions and assesses operating performance.

Product Revenue

We derive our product revenue primarily from the sale of spinal fusion devices and related products used in the treatment of spine disorders. Our product revenue is generated from sales to three types of customers: (1) surgeons and hospitals; (2) stocking distributors; and (3) private label customers. Most of our products are sold on a consignment basis through a network of independent sales distributors; however, we also sell our products to independent stocking distributors and private label customers. Product revenue is recognized when all four of the following criteria are met: (1) persuasive evidence that an arrangement exists; (2) delivery of the products has occurred; (3) the selling price of the product is fixed or determinable; and (4) collectability is reasonably assured. We generate the majority of our revenue from the sale of inventory that is consigned to independent sales distributors that sell our products to surgeons and hospitals. For these products, we recognize revenue at the time we are notified the product has been used or implanted and all other revenue recognition criteria have been met. For all other transactions, we recognize revenue when title and risk of loss transfer to the stocking distributor or private label customers, and all other revenue recognition criteria have been met. We generally recognize revenue from sales to stocking distributors and private label customers at the time the product is shipped to the distributor. Stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership at time of shipment. Our stocking distributors are obligated to pay within specified terms regardless of when, if ever, they sell the products. Our policy is to classify shipping and handling costs billed to customers as an offset to total shipping expense in the statement of operations, primarily within sales and marketing. In general, our customers do not have any rights of return or exchange.

We believe our product revenue from the sale of our silicon nitride based products will increase due to our sales and marketing efforts and as we introduce new silicon nitride based products into the market and our product revenue from the sale of our non-silicon nitride products to remain flat. We expect that our product revenue will continue to be primarily attributable to sales of our products in the United States.

Cost of Revenue

The expenses that are included in cost of revenue include all direct product costs if we obtained the product from third-party manufacturers and our in-house manufacturing costs for the products we manufacture. We obtain our non-silicon nitride products, including our metal and orthobiologic products, from third-party manufacturers, while we

currently manufacture our silicon-nitride products in-house.

Specific provisions for excess or obsolete inventory are also included in cost of revenue. In addition, we pay royalties attributable to the sale of specific products to some of our surgeon advisors that assisted us in the design, regulatory clearance or commercialization of a particular product. These payments are recorded as cost of revenue.

Gross Profit

Our gross profit measures our product revenue relative to our cost of revenue. We expect our gross profit to decrease as we expand the penetration of our silicon nitride technology platform through OEM and private label partnerships.

Research and Development Expenses

Our net research and development costs are expensed as incurred. Research and development costs consist of engineering, product development, clinical trials, test-part manufacturing, testing, developing and validating the manufacturing process, manufacturing, facility and regulatory-related costs. Research and development expenses also include employee compensation, employee and non-employee stock-based compensation, supplies and materials, consultant services, and travel and facilities expenses related to research activities. To the extent that certain research and development expenses are directly related to our manufactured products, such expenses and related overhead costs are allocated to inventory.

We expect to incur additional research and development costs as we continue to develop new spinal fusion products, our product candidates for total joint replacements, such as our total hip replacement product candidate, and our silicon nitride-coated metals which may increase our total research and development expenses.

Sales and Marketing Expenses

Sales and marketing expenses consist of salaries, benefits and other related costs, including stock-based compensation, for personnel employed in sales, marketing, medical education and training. In addition, our sales and marketing expenses include commissions and bonuses, generally based on a percentage of sales, to our sales managers and independent sales distributors. We provide our products in kits or banks that consist of a range of device sizes and separate instruments sets necessary to perform the surgical procedure. We generally consign our instruments to our distributors or our hospital customers that purchase the device used in spinal fusion surgery. Our sales and marketing expenses include depreciation of the surgical instruments.

We expect our sales and marketing expenses will remain flat or slightly decline due to the cost saving measures implemented during the first quarter. Additionally, we expect our commissions to increase in absolute terms over time but remain approximately the same or decrease as a percentage of product revenue.

General and Administrative Expenses

General and administrative expenses primarily consist of salaries, benefits and other related costs, including stock-based compensation, for certain members of our executive team and other personnel employed in finance, legal, compliance, administrative, information technology, customer service, executive and human resource departments. General and administrative expenses include allocated facility expenses, related travel expenses and professional fees for accounting and legal services.

We expect our general and administrative expenses to remain relatively flat.

RESULTS OF OPERATIONS

The following is a tabular presentation of our condensed consolidated operating results for the three months ended March 31, 2016 and 2015 (*in thousands*):

| Three Months Ended March 31, | |
|---------------------------------|------|
| 2016 | 2015 |

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| | | | \$ | % |
|------------------------------|-----------|-----------|---------|--------|
| | | | Change | Change |
| Product revenue | \$4,173 | \$4,743 | \$(570) | (12)% |
| Costs of revenue | 893 | 1,522 | (629) | (41)% |
| Gross profit | 3,280 | 3,221 | 59 | 2% |
| Operating expenses: | | | | |
| Research and development | 1,608 | 1,843 | (235) | (13)% |
| General and administrative | 1,562 | 2,027 | (465) | (23)% |
| Sales and marketing | 2,594 | 3,357 | (763) | (23)% |
| Total operating expenses | 5,764 | 7,227 | (1,463) | (20)% |
| Loss from operations | (2,484) | (4,006) | 1,522 | 38% |
| Other income (expense), net | (904) | (1,375) | 471 | 34% |
| Net loss before income taxes | (3,388) | (5,381) | 1,993 | 37% |
| Provision for income taxes | - | - | - | |
| Net loss | \$(3,388) | \$(5,381) | \$1,993 | 37% |

Product Revenue

The following table sets forth our product revenue from sales of the indicated product category for the three months ended March 31, 2016 and 2015 (in thousands):

| | Three Months Ended March 31, | | \$ | % |
|-----------------------|------------------------------------|---------|---------|--------|
| | 2016 | 2015 | Change | Change |
| Silicon Nitride | \$2,238 | \$2,658 | \$(420) | (16) % |
| Non-Silicon Nitride | 1,935 | 2,085 | (150) | (7) % |
| Total product revenue | \$4,173 | \$4,743 | \$(570) | (12) % |

For the three months ended March 31, 2016, total product revenue was \$4.2 million as compared to \$4.7 million in the same period 2015, a decrease of \$0.5 million, or 12%. This decrease was due to lower private label sales during the quarter and weaker than expected commercial sales in a key geographic area during the implementation of our commercial sales expansion strategy. The decrease in revenue for the three months ended March 31, 2016 was also attributable, in part, to continued market pricing pressure and hospital vendor consolidation.

The following table sets forth, for the periods indicated, our product revenue by geographic area (in thousands):

| | Three Months Ended March 31, | | \$ | % |
|-----------------------|------------------------------------|---------|----------|--------|
| | 2016 | 2015 | Change | Change |
| Domestic | \$4,009 | \$4,732 | \$ (723) | (15)% |
| International | 164 | 11 | 153 | 1,391% |
| Total product revenue | \$4,173 | \$4,743 | \$ (570) | (12)% |

International revenue increased \$0.2 million during the three months ended March 31, 2016 as compared to the same periods in 2015, primarily as a result of increased sales of our silicon nitride products in Brazil and Europe.

Cost of Revenue and Gross Profit

For the three months ended March 31, 2016, our cost of revenue decreased \$0.6 million, or 41%, as compared to the same period in 2015. The decrease was primarily due to the decline in sales and the moratorium on the medical device excise tax in addition to receiving a refund for the medical device excise tax. Furthermore, there was minimal private label revenue during the three months ended March 31, 2016 resulting in increased gross profit during the three months ended March 31, 2016 as compared to the same period in 2015.

Research and Development Expenses

For the three months ended March 31, 2016, research and development expenses decreased \$0.2 million, or 13%, as compared to the same period in 2015. This decrease was primarily attributable to a \$0.5 million decrease in personnel related expenses and a \$0.1 million decrease of stock compensation expense. These improvements were offset by an increase of \$0.3 million of costs that were not capitalized to inventory due to lower inventory production rates in 2016 as compared to 2015.

General and Administrative Expenses

For the three months ended March 31, 2016, general and administrative expenses decreased \$0.5 million, or 23%, as compared to the same period in 2015. This decrease was primarily attributable to a \$0.3 million decrease in personnel related expenses and a \$0.3 million decrease in stock compensation expense. These improvements were offset, in part, by a \$0.1 million increase in patent related expenses during the quarter.

Sales and Marketing Expenses

For the three months ended March 31, 2016, sales and marketing expenses decreased \$0.8 million, or 23%, as compared to the same period in 2015. This decrease was primarily attributable to a \$0.4 million decrease in personnel related expenses, a decrease of \$0.1 million of stock compensation expense, and a decrease of \$0.3 million in commissions due to lower sales.

Other Income (Expense), Net

For the three months ended March 31, 2016, other expense decreased \$0.5 million, or 34%, as compared to the same period in 2015. This decrease was primarily due to a net decrease of \$0.2 million in the change in fair value of derivative liabilities due to the significant reduction in the balance of our derivative liabilities and a decrease of \$0.2 million in interest expense as a result of lower debt balances. Additionally, there was a decrease of \$0.1 million from a loss on extinguishment of debt during three months ended March 31, 2015.

Liquidity and Capital Resources

For the three months ended March 31, 2016 and 2015, we incurred a net loss of \$3.4 million and \$5.4 million, respectively, and used cash in operations of \$1.5 million and \$3.0 million, respectively. We have an accumulated deficit of \$199.9 million as of March 31, 2016. To date, our operations have been principally financed from proceeds from the issuance of convertible preferred stock and common stock, convertible debt and bank debt and, to a lesser extent, cash generated from product sales. As of March 31, 2016, we had approximately \$7.9 million in cash and cash equivalents.

We will need to, from time-to-time, seek additional financing through the issuance of common stock and/or debt, to satisfy our debt obligations and financial covenants, meet our working capital requirements, make continued investment in research and development and make capital expenditures needed for us to maintain and expand our business. We anticipate we will need to obtain additional funding early in the third quarter of 2016 to maintain compliance with the financial and liquidity covenants related to the Hercules Term Loan. If the Company is unable to access additional funds prior to becoming non-compliant with the financial and liquidity covenants related to the Hercules Term Loan, the entire remaining balance of the debt under the Hercules Term Loan could become immediately due and payable at the option of Hercules Technology. We may not be able to obtain additional financing on terms favorable to us, if at all. It is also possible that we may allocate significant amounts of capital toward solutions or technologies for which market demand is lower than anticipated and, as a result, abandon such efforts. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, or if we expend capital on projects that are not successful, our ability to continue to support our business growth and to respond to business challenges could be significantly limited, or we may even have to scale back our operations. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock

Going Concern

Our ability to access capital when needed is not assured and, if not achieved on a timely basis, will materially harm our business, financial condition and results of operations. These uncertainties create substantial doubt about our ability to continue as a going concern. Our independent registered public accounting firm included an explanatory paragraph regarding substantial doubt about our ability to continue as a going concern in their report on our annual financial statements for the fiscal year ended December 31, 2015. The financial information throughout this quarterly report have been prepared on a basis which assumes that we will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. This financial information and statements do not include any adjustments that may result from the outcome of this uncertainty.

Cash Flows

The following table summarizes, for the periods indicated, cash flows from operating, investing and financing activities (in thousands):

| | Three Months Ended March 31, | |
|---------------------------------------|---------------------------------|-----------|
| | 2016 | 2015 |
| Net cash used in operating activities | \$(1,465) | \$(2,971) |
| Net cash used in investing activities | (243) | (274) |

| | | |
|---------------------------------------|-----------|-----------|
| Net cash used in financing activities | (1,834) | (120) |
| Net cash used | \$(3,542) | \$(3,365) |

Net Cash Used in Operating Activities

Net cash used in operating activities decreased \$1.5 million to \$1.5 million during the three months ended March 31, 2016, from \$3.0 million for the same period in 2015. The decrease in cash used in operating activities during 2016 was primarily due to an overall decrease of \$1.1 million in operational expenditures as we continue to focus our efforts to reduce costs. Additionally, accounts receivable decreased \$0.8 million, which was offset by an increase of \$0.4 million in accounts payable and prepaid expenses.

Net Cash Used in Investing Activities

Net cash used in investing activities during the three months ended March 31, 2016 was consistent with the level of cash used in the same period 2015. This cash was used to replenish our inventory of instrumentation.

Net Cash Used in Financing Activities

Net cash used in financing activities was \$1.8 million during the three months ended March 31, 2016, compared to \$0.1 million used during the same period in 2015. This increase in net cash used by financing activities in 2016 was primarily attributable to principal payments made on our notes payable.

Indebtedness

Hercules Term Loan

On June 30, 2014, we entered into a Loan and Security Agreement with Hercules which provided the Company with a \$20 million term loan. The Hercules Term Loan matures on January 1, 2018. The Hercules Term Loan included a \$200,000 closing fee, which was paid to Hercules on the closing date of the loan. The closing fee was recorded as a debt discount and is being amortized to interest expense over the life of the loan. The Hercules Term Loan also includes a non-refundable final payment fee of \$1.7 million. The final payment fee is being accrued and recorded to interest expense over the life of the loan. The Hercules Term Loan bears interest at the rate of the greater of either (i) the prime rate plus 9.2%, and (ii) 12.5%, which was 12.7% at March 31, 2016. Interest accrues from the closing date of the loan and interest payments are due monthly. Principal payments commenced August 1, 2015 and are to be made

in 30 equal installments of approximately \$700,000, with the remainder due at maturity. The Company's obligations to Hercules are secured by a first priority security interest in substantially all of its assets, including intellectual property. The Hercules Term Loan contains certain covenants related to restrictions on payments to certain Company affiliates and financial reporting requirements.

On September 8, 2015, we entered into a Consent and First Amendment to Loan and Security Agreement with Hercules. The Amendment modified the liquidity covenant to reduce the minimum cash balance required by \$500,000 for every \$1.0 million paid in principal to a minimum of \$2.5 million. The minimum cash and cash equivalents balance required to maintain compliance with the minimum liquidity covenant at March 31, 2016 was \$7.0 million. Although the Company was in compliance with the liquidity covenant at March 31, 2016, we anticipate that we will be non-compliant with the liquidity covenant early in the third quarter of 2016 if additional financing is not obtained or the loan is not restructured, and has therefore classified the entire obligation as a current liability.

As discussed previously in Recent Developments under the headings “*Hercules and Riverside Debt Assignment*”, Hercules sold \$3.0 million in principal of its term loan to Riverside during April 2016. Following the assignment, the monthly principal payments were reduced to approximately \$500,000. See additional information above in Recent Developments under the headings, “*Hercules and Riverside Debt Assignment*” and “*Riverside Debt Exchange.*”

Magna Note

The outstanding principal amount of the Magna Note was \$763,000 at March 31, 2016. The Magna Note matures on August 11, 2016, and accrues interest at an annual rate of 6.0%. We have agreed to pay an additional \$0.8 million to redeem in full the remaining principal balance and interest if the Company receives gross proceeds of \$3.6 million from the sale of equity securities.

Riverside Debt Exchange

For a description of our indebtedness to Riverside, see information above under the heading in Recent Developments “*Riverside Debt Exchange.*”

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as defined in Item 303(a)(4) of Regulation S-K.

Critical Accounting Policies and Estimates

A summary of our significant accounting policies and estimates is discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no material changes to those policies during the three months ended March 31, 2016. The preparation of the financial statements in accordance with U.S. generally accepted accounting principles requires us to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities. Significant areas of uncertainty that require judgments, estimates and assumptions include the accounting for income taxes and other contingencies as well as valuation of derivative liabilities, asset impairment and collectability of accounts receivable. We use historical and other information that we consider to be relevant to make these judgments and estimates. However, actual results may differ from those estimates and assumptions that are used to prepare our financial statements.

New Accounting Pronouncements

See discussion under Note 1, *Organization and Summary of Significant Accounting Policies*, to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q, for information on new accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

This Report includes the certifications of our Chief Executive Officer and Principal Accounting Officer required by Rule 13a-14 of the Securities Exchange Act of 1934 (the "Exchange Act"). See Exhibits 31.1 and 31.2. This Item 4 includes information concerning the controls and control evaluations referred to in those certifications.

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in rules and forms adopted by the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Principal Accounting Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this report, our management, under the supervision and with the participation of our Chief Executive Officer and our Principal Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2016.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the first quarter of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

On April 1, 2016, Hampshire MedTech Partners II, GP (“Hampshire GP”) filed suit against us in the Travis County, Texas 200th Judicial District Court relating to a Warrant to Purchase Shares of Common Stock issued by us to Hampshire MedTech Partners II, LP (“Hampshire LP”) on November 6, 2014 (the “Warrant”). Hampshire GP alleges that as a result of a subsequent financing we breached the anti-dilution provision of the Warrant by failing to increase the number of shares subject to the Warrant as well as failing to reduce the exercise price of the Warrant. Hampshire GP seeks damages in excess of \$1,000,000. We have not yet answered Hampshire GP’s complaint and we intend to vigorously defend ourselves in this suit.

We are not aware of any other pending or threatened legal proceeding against us that could have a material adverse effect on our business, operating results or financial condition. The medical device industry is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, we may be involved in various additional legal proceedings from time to time.

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

Unregistered Sales of Equity Securities

From, April 6, 2016 to May 13, 2016 the Company issued Riverside Merchant Partners, LLC (“Riverside”) a total of 1,812,788 shares of common stock in connection with the conversion of \$2.4 million in convertible debt principal and interest held by Riverside. The recipient is an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on exemptions provided by Section 4(2) of the Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description | Filed Herewith | Incorporated by Reference herein from Form or Schedule | Filing Date | SEC File/Reg. Number |
|-----------------------|---|-----------------------|---|--------------------|-----------------------------|
| 4.1 | Common Stock Purchase Warrant | | Form 8-K | 04/05/2016 | 001-33624 |
| 10.1 | Assignment and Second Amendment to Loan and Security Agreement, dated April 4, 2016, by and among the Company Riverside Merchant Partners, LLC, Hercules Technology III, L.P. and Hercules Capital, Inc., the financial institutions signatory thereto, Amedica Corporation, and the guarantors signatory thereto | | Form 8-K | 04/05/2016 | 001-33624 |
| 10.2 | Exchange Agreement dated April 4, 2016, by and among Amedica Corporation and Riverside Merchant Partners, LLC | | Form 8-K | 04/05/2016 | 001-33624 |
| 10.3 | Subordinated Convertible Promissory Note, dated April 4, 2016, by and among Amedica Corporation and Riverside Merchant Partners, LLC | | Form 8-K | 04/05/2016 | 001-33624 |
| 31.1 | Certificate of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 31.2 | Certificate of the Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 101.INS | XBRL Instance Document | X | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | X | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | X | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | X | | | |
| 101.LAB | | X | | | |

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XBRL Taxonomy Extension Label Linkbase
Document

| | | |
|---------|---|---|
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | X |
|---------|---|---|

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMEDICA CORPORATION

Date: May 13, 2016 */s/ B. Sonny Bal*
B. Sonny Bal
Chief Executive Officer
(Principal Executive Officer)

Date: May 13, 2016 */s/ Ty A. Lombardi*
Ty A. Lombardi
Chief Financial Officer
(Principal Financial and Accounting Officer)

