Cardiovascular Systems Inc
Form 10-Q
May 04, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
Commission File No. 000-52082

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

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

1225 Old Highway 8 Northwest
St. Paul, Minnesota 55112-6416
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code: (651) 259-1600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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 April 27, 2018 was: Common Stock, $0.001 par value per share, 33,258,205 shares.

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PART I. — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Cardiovascular Systems, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share and share amounts)
(Unaudited)

	March 31, 2018	June 30, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$109,305	$107,912
Accounts receivable, net	31,941	28,472
Inventories	17,002	16,897
Marketable securities	586	704
Prepaid expenses and other current assets	2,350	5,074
Total current assets	161,184	159,059
Property and equipment, net	28,165	29,696
Patents, net	5,148	5,056
Other assets	262	129
Total assets	$194,759	$193,940
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$9,836	$10,736
Accrued expenses	24,765	30,236
Deferred revenue	1,554	—
Total current liabilities	36,155	40,972
Long-term liabilities		
Financing obligation	21,083	21,100
Deferred revenue	9,023	10,000
Other liabilities	2,042	3,479
Total liabilities	68,303	75,551
Commitments and contingencies (see Note 7)		
Common stock, $0.001 par value; authorized 100,000,000 common shares at March 31, 2018 and June 30, 2017; issued and outstanding 33,258,205 at March 31, 2018 and 32,849,563 at June 30, 2017, respectively	33	33
Additional paid in capital	457,648	447,559
Accumulated other comprehensive income	103	100
Accumulated deficit	(331,328)	(329,303)
Total stockholders' equity	126,456	118,389
Total liabilities and stockholders' equity	$194,759	$193,940

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 March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Net revenues	$55,587	$ 52,144	$157,891	$151,987
Cost of goods sold	9,969	11,139	28,670	29,768
Gross profit	45,618	41,005	129,221	122,219
Expenses:				
Selling, general and administrative	37,796	37,332	110,722	108,191
Research and development	7,333	5,432	20,037	16,572
Total expenses	45,129	42,764	130,759	124,763
Income (loss) from operations	489	(1,759)	(1,538)	(2,544)
Other (income) expense, net:				
Interest expense	429	20	1,291	66
Interest income and other, net	(338)	(48)	(903)	(112)
Total other (income) expense, net	91	(28)	388	(46)
Income (loss) before income taxes	398	(1,731)	(1,926)	(2,498)
Provision for income taxes	33	18	99	66
Net income (loss)	$365	$ (1,749)	$(2,025)	$(2,564)
Basic earnings per share	$0.01	$ (0.05)	$(0.06)	$(0.08)
Diluted earnings per share	$0.01	$ (0.05)	$(0.06)	$(0.08)
Basic weighted average shares outstanding	33,237,552	32,650,974	33,105,174	32,232,409
Diluted weighted average shares outstanding	33,641,804	32,650,974	33,105,174	32,232,409

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Net income (loss)	$365	$(1,749)	$(2,025)	$(2,564)
Other comprehensive income:				
Unrealized gain (loss) on available for sale securities	(1)	20	27	57
Adjustment for net gain realized and included in other income, net	(8)	—	(24)	—
Total change in unrealized gain (loss) on available for sale securities	(9)	20	3	57
Comprehensive income (loss)	$356	$(1,729)	$(2,022)	$(2,507)

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

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

	Nine Months Ended March 31,	
	2018	2017
Cash flows from operating activities		
Net loss	$(2,025)	$(2,564)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation of property and equipment	2,927	2,932
Amortization and write-off of patents	650	883
Provision for (recovery of) doubtful accounts	(18)	315
Loss on disposal of equipment	—	158
Stock-based compensation	7,880	8,336
Changes in assets and liabilities		
Accounts receivable	(3,594)	(5,064)
Inventories	(105)	835
Prepaid expenses and other assets	2,879	(153)
Accounts payable	(544)	190
Accrued expenses and other liabilities	(6,945)	615
Deferred revenue	577	10,000
Net cash provided by operating activities	1,682	16,483
Cash flows from investing activities		
Purchases of property and equipment	(1,614)	(841)
Proceeds from convertible note receivable	143	—
Sales of marketable securities	144	—
Costs incurred in connection with patents	(880)	(496)
Net cash used in investing activities	(2,207)	(1,337)
Cash flows from financing activities		
Proceeds from employee stock purchase plan	1,385	1,400
Exercise of stock options	513	5,002
Proceeds from financing	—	20,944
Other	20	—
Net cash provided by financing activities	1,918	27,346
Net change in cash and cash equivalents	1,393	42,492
Cash and cash equivalents		
Beginning of period	107,912	60,638
End of period	$109,305	$103,130

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

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CARDIOVASCULAR SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(For the Nine Months Ended March 31, 2018 and 2017)
(Dollars in thousands, except per share and share amounts)
(Unaudited)

1. Business Overview

Company Description

Cardiovascular Systems, Inc. (the "Company" or "CSI") develops, manufactures and markets devices for the treatment of vascular diseases. The Company's peripheral arterial disease ("PAD") products, the Diamondback 360® Peripheral Orbital Atherectomy System ("OAS") and the Stealth 360® Peripheral OAS, 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 these products address many of the limitations associated with other surgical, catheter and pharmacological treatment alternatives. These devices use smaller access sheaths that can provide procedural benefits and allow physicians to treat PAD patients in a variety of vessel sizes, including the small and tortuous vessels located below the knee, and facilitate access through alternative sites in the ankle, foot and wrist, as well as in the groin. The Company refers to the products above as the "Peripheral OAS."

In October 2013, the Company received premarket approval from the United States Food and Drug Administration ("FDA") to market the Diamondback 360 Coronary OAS (the "Coronary OAS") as a treatment for severely calcified coronary arteries. In March 2017, the Company received approval from the FDA to market the Diamondback 360 Coronary OAS Micro Crown (the "Coronary OAS Micro Crown").

In January 2018, the Company announced two new relationships that broaden the Company's product portfolio. The Company is now the exclusive U.S. distributor of OrbusNeich® balloon products. In March 2018, the FDA granted 510(k) clearance for the OrbusNeich 1.0mm Sapphire® 11 Pro coronary balloon ("1.0mm balloon"). The 1.0mm balloon, the first and only 1.0mm coronary balloon available in the United States, offers industry-leading entry and crossing profiles and is precision engineered for crossing and treating extremely tight and complex lesions. The Company anticipates OrbusNeich's full coronary balloon product portfolio will become available in 2018 and 2019.

In January 2018, the Company also announced that it entered into an original equipment manufacturer agreement with Integer Holdings Corporation for CSI-branded ZILIENT™ guidewires. The broad market launch of the CSI-branded ZILIENT peripheral guidewires is expected to begin later in the current fiscal year. The Company anticipates that additional ZILIENT guidewires for coronary interventions and radial peripheral interventions will become available in the future.

In February 2018, the Company announced that the first patients were treated using its FDA-cleared extended length Diamondback 360® Peripheral OAS to treat PAD. Radial access allows physicians to reach and treat lower limb PAD lesions through the radial artery in the wrist, providing an alternative access point and more options to treat complicated and at-risk patients. The Company is currently in a limited market rollout with an anticipated full commercial launch in fiscal 2019.

In November 2016, the Company signed an exclusive distribution agreement with Medikit Co., Ltd. ("Medikit") to sell its Coronary and Peripheral OAS in Japan. In March 2017, the Company received approval from Japan's Ministry of Health, Labor and Welfare for its Coronary OAS Micro Crown. On February 1, 2018, the Coronary OAS Micro Crown received reimbursement approval in Japan, followed by the first commercial sales, making Japan the first international market for any of the Company's products. The Coronary OAS Micro Crown is the only atherectomy

device designed to both pilot tight, calcific lesions and treat 2.5 to 4 mm vessels with a single device. The Company is currently evaluating options for additional international markets to expand the coronary and peripheral opportunities.

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2. Summary of Significant Accounting Policies

Interim Financial Statements

The Company prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. The year-end consolidated balance sheet was derived from the Company's audited consolidated financial statements, but does not include all disclosures as required by GAAP. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair statement of the Company's consolidated financial position, the results of its operations and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Annual Report on Form 10-K filed by the Company with the SEC on August 24, 2017. 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.

Use of Estimates

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

Stock-Based Compensation

The Company has stock-based compensation plans, which include stock options, nonvested share awards, and an employee stock purchase plan. Fair value of option awards is determined using option-pricing models, fair value of nonvested share awards with market conditions is determined using the Monte Carlo simulation, and fair value of nonvested share awards that vest based upon service conditions is determined by the closing market price of the Company's stock on the date of grant. Stock-based compensation expense is recognized ratably over the requisite service period for the awards expected to vest.

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. Revenue recognition may occur upon shipment or upon delivery to the customer site, based on the contract terms. The Company records estimated sales returns, discounts and rebates as a reduction of net sales.

Deferred revenue associated with the upfront payment received under the Company's distribution agreement with Medikit (see Note 3 for additional details) is recognized in relation to the estimated future sales under the agreement. The short term portion represents the expected amount of deferred revenue that will be recognized over the next year. The estimate of future sales under contract will continue to be assessed and adjusted accordingly.

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.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued amended revenue recognition guidance to clarify the principles for recognizing revenue from contracts with customers. The guidance requires an entity to recognize revenue in an amount that reflects the consideration to which an entity expects to be entitled in exchange for the transfer of goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The Company is continuing its process of analyzing the impact of the new standard. The Company has reviewed its customer contracts, applying the five-step model of the new standard to the customer contracts and assessing the results to the Company's current accounting. The Company is also evaluating the method of adoption and assessing changes that might be necessary to information technology systems, processes, and internal controls to capture new data and address changes in financial reporting. Effective July 1, 2018, the Company will be revising its revenue recognition accounting policy and

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expanding revenue disclosures to reflect the requirements of the amended revenue recognition guidance. Because of the nature of the work that remains, at this time the Company is unable to reasonably estimate the impact of adoption on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities,” which revises the accounting requirements related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The update also changes certain disclosure requirements associated with the fair value of financial instruments. These changes will require an entity to measure, at fair value, investments in equity securities and recognize the changes in fair value within net income. ASU 2016-01 will be applied on a modified retrospective basis to all outstanding instruments, with an adjustment recorded to opening retained earnings as of the beginning of the first period in which the guidance becomes effective. The guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The guidance is effective for the Company on July 1, 2018. The Company does not anticipate a material impact on its financial statements upon adoption.

In February 2016, the FASB issued ASU 2016-02, “Leases.” The guidance requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, and should be applied using a modified retrospective approach. Early adoption is permitted. The guidance is effective for the Company on July 1, 2019. The Company is currently evaluating the timing, method of adoption and impact of the new lease guidance on its financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Measurement of Credit Losses on Financial Instruments,” which revises guidance for the accounting for credit losses on financial instruments within its scope. The new standard introduces an approach, based on expected losses, to estimate credit losses on certain types of financial instruments and modifies the impairment model for available-for-sale debt securities. The new approach to estimating credit losses (referred to as the current expected credit losses model) applies to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases and off-balance-sheet credit exposures. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted and should be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The guidance is effective for the Company on July 1, 2020. The Company does not anticipate a material impact on its financial statements upon adoption.

In May 2017, the FASB issued ASU 2017-09, “Scope of Modification Accounting,” which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance will reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The guidance is effective for annual periods, and interim periods within those annual periods beginning after December 15, 2017, with early adoption permitted. The guidance is effective for the Company on July 1, 2018. The Company does not anticipate a material impact on its financial statements upon adoption.

3. Selected Consolidated Financial Statement Information

Accounts Receivable, Net

Accounts receivable consists of the following:

June 30,

	March 31, 2018	2017
Accounts receivable	$32,742	$29,336
Less: Allowance for doubtful accounts	(801)	(864)
Accounts receivable, net	$31,941	$28,472

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Inventories

Inventories consist of the following:

	March 31, 2018	June 30, 2017
Raw materials	$7,919	$7,898
Work in process	1,354	1,221
Finished goods	7,729	7,778
Inventories	$17,002	$16,897

Property and Equipment, Net

Property and equipment consists of the following:

	March 31, 2018	June 30, 2017
Land	$500	$500
Building	22,420	22,420
Equipment	17,034	16,502
Furniture	2,709	2,709
Leasehold improvements	438	86
Construction in progress	924	421
	44,025	42,638
Less: Accumulated depreciation	(15,860)	(12,942)
Property and equipment, net	$28,165	$29,696

In December 2016, the Company entered into a Purchase and Sale Agreement, as subsequently amended (collectively, the “Sale Agreement”), with Krishna Holdings, LLC (“Krishna”), providing for the sale to Krishna of the Company’s headquarters facility in St. Paul, Minnesota (the “Facility”) for a cash purchase price of $21,500. On March 30, 2017, the sale of the Facility under the Sale Agreement closed. The Company received proceeds of approximately $20,944 ($21,500, less $556 of transaction expenses). The net proceeds are to be used for working capital and general corporate purposes.

Under the Sale Agreement, the Company entered into a Lease Agreement (the “Lease Agreement”) with Krishna Holdings, LLC, Apex Holdings, LLC, Kashi Associates, LLC, Keva Holdings, LLC, S&V Ventures, LLC, Polo Group LLC, SPAV Holdings LLC, Star Associates LLC, and The Global Villa, LLC. As the lease terms resulted in a capital lease classification, the Company accounted for the sale and leaseback of the Facility as a financing transaction where the assets remain on the Company’s balance sheet. See Note 4 for further discussion of future payment obligations under the Lease Agreement.

Accrued Expenses

Accrued expenses consist of the following:

	March 31, 2018	June 30, 2017
Salaries and bonus	$4,214	$8,247
Commissions	8,075	8,217

Accrued vacation	3,520	3,436
Accrued excise, sales and other taxes	3,555	3,497
Accrued legal	—	2,600
Legal settlement	1,839	1,814
Clinical studies	1,163	657
Other accrued expenses	2,399	1,768
Accrued expenses	$24,765	$30,236

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Legal Settlement

On June 28, 2016, the Company entered into a Settlement Agreement (the "Settlement Agreement") with the United States of America, acting through the Department of Justice (the "DOJ") and on behalf of the Office of Inspector General of the Department of Health and Human Services, and Travis Thams, to resolve the previously disclosed DOJ investigation and the qui tam complaint filed by Thams pursuant to the False Claims Act. Under the Settlement Agreement, the Company agreed to pay $8,000 (the "Settlement Amount") as follows: an initial payment of $3,000, paid on July 1, 2016, with the remaining $5,000, which bears interest at 1.8% per annum, payable in 11 equal quarterly installments, beginning January 1, 2017. The amount payable within the next twelve months is included in accrued expenses (as noted in the table above) with the long-term portion included in other liabilities (as noted in the table below). Under the Settlement Agreement, if the Company makes a single payment in excess of $2,000, which payment is not covered by an insurance policy, in settlement of any claims before paying the full Settlement Amount, the remaining unpaid balance of the Settlement Amount will become immediately due and payable, with interest accruing on the unpaid principal portion at an interest rate of 1.8% per annum.

Other Liabilities

Other non-current liabilities consist of the following:

	March 31, 2018	June 30, 2017
Legal settlement	$932	$2,314
Deferred compensation	439	519
Deferred grant incentive	464	473
Other non-current liabilities	207	173
Other liabilities	$2,042	$3,479

Deferred Revenue

In November 2016, the Company signed an exclusive distribution agreement with Medikit to sell its Coronary and Peripheral OAS in Japan. To secure exclusive distribution rights, Medikit made an upfront payment of $10,000 to the Company, which is refundable based on performance under the terms of the agreement. In February 2018, the Coronary OAS Micro Crown received reimbursement approval in Japan, followed by the first commercial sales. Accordingly, the Company has classified $802 of the upfront payment as current and $9,023 as long-term based on its expected amount of deferred revenue that will be recognized over the next year. The estimate will be assessed and adjusted accordingly on a quarterly basis.

The Company also has $752 of current deferred revenue related to the prepayment of an order from Medikit that will be shipped during the three months ended June 30, 2018.

4. Debt

Revolving Credit Facility

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

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

The Company's obligations under the Loan Agreement are secured by certain of the Company's assets, including, among other things, accounts receivable, deposit accounts, inventory, equipment, general intangibles and records pertaining to the foregoing.

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

Under the Loan Agreement, the Company paid SVB a non-refundable commitment fee of $80, which will be amortized to interest expense over the term of the Loan Agreement. The Company is required to pay a fee equal to 0.35% per annum on the unused portion of the Revolver, payable quarterly in arrears. The Company is not obligated to draw any funds under the Revolver and has not done so under the Revolver since entering into the Loan Agreement. No amounts are outstanding as of March 31, 2018.

Financing Obligation

In connection with the sale of the Facility, the Company entered into an agreement to lease the Facility. The Lease Agreement has an initial term of fifteen years, with four consecutive renewal options of five years each at the Company's option, with a base annual rent in the first year of $1,638 and annual escalations of 3% thereafter. Rent during subsequent renewal terms will be at the then fair market rental rate. As the lease terms resulted in a capital lease classification, the Company accounted for the sale and leaseback of the Facility as a financing transaction where the assets remain on the Company's balance sheet and a financing obligation was recorded for $20,944. As lease payments are made, they will be allocated between interest expense and a reduction of the financing obligation, resulting in a value of the financing obligation that is equivalent to the net book value of the assets at the end of the lease term. The effective interest rate is 7.89%. At the end of the lease (including any renewal option terms), the Company will remove the assets and financing obligation from its balance sheet.

Payments under the initial term of the Lease Agreement as of March 31, 2018 are as follows:

Three months ended June 30, 2018	$422
Fiscal 2019	1,699
Fiscal 2020	1,750
Fiscal 2021	1,803
Fiscal 2022	1,857
Thereafter	21,288
	$28,819

5. Deferred Compensation Plan

The Company offers certain members of management and highly compensated employees the opportunity to defer up to 100% of their base salary (after 401(k), payroll tax and other deductions), performance bonus and discretionary bonus and elect to receive the deferred compensation at a fixed future date of participant's choosing. Each participant may, at the time of his or her deferral election, choose to allocate the deferred compensation into investment alternatives set by the Human Resources and Compensation Committee. The amount payable to each participant under the plan will change in value based upon the investment selected by that participant and is classified as current or long-term on the Company's balance sheet based on the disbursement elections made by the participants. As of

March 31, 2018, $195 of the amount payable is included in accrued liabilities and $439 is included in other liabilities on the consolidated balance sheet.

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The available-for-sale marketable securities are comprised of individual mutual funds which invest in fixed income and equity securities and consist of the following:

	As of March 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Mutual funds	$483	$ 103	$ —	$ 586
Total short-term investments	$483	$ 103	$ —	$ 586

	As of June 30, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Mutual funds	$604	$ 100	$ —	$ 704
Total short-term investments	$604	$ 100	$ —	$ 704

During the three and nine months ended March 31, 2018 and 2017, there were no purchases of available-for-sale securities or other-than-temporary impairments. There was $48 and $144 of available-for-sale securities that were sold during the three and nine months ended March 31, 2018, respectively. There were no sales during the three and nine months ended March 31, 2017. During the three and nine months ended March 31, 2018, there was a realized gain of $8 and $24, respectively, that was recorded within interest and other, net on the consolidated statement of operations. There were no realized gains or losses in the three and nine months ended March 31, 2017.

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

		Fair Value Measurements as of March 31, 2018 Using Inputs Considered as		
	Fair Value	Level 1	Level 2	Level 3
Mutual funds	$ 586	$ 221	$ 365	$ —
Total short-term investments	$ 586	$ 221	$ 365	$ —

		Fair Value Measurements as of June 30, 2017 Using Inputs Considered as		
	Fair Value	Level 1	Level 2	Level 3
Mutual funds	$ 704	$ 281	$ 423	$ —
Total short-term investments	$ 704	$ 281	$ 423	$ —

The Company’s marketable securities classified within Level 1 are valued using real-time quotes for transactions in active exchange markets. Marketable securities within Level 2 are valued using readily available pricing sources. There were no transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the nine months ended March 31, 2018. Any transfers between levels would be recognized on the date of the event or when a change in circumstances causes a transfer.

6. Stock Options and Restricted Stock Awards

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

Stock Options

All options granted under the Plans become exercisable over periods established at the date of grant. The option exercise price is generally not less than the estimated fair market value of the Company's common stock at the date of grant, as determined by the Company's management and Board of Directors. An employee's vested options must be exercised at or within 90 days of termination to avoid forfeiture. As of March 31, 2018, all outstanding options were fully vested.

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Stock option activity for the nine months ended March 31, 2018 is as follows:

	Number of Options[(a)]	Weighted Average Exercise Price
Options outstanding at June 30, 2017	78,201	$ 9.07
Options exercised	(55,880)	$ 9.20
Options outstanding at March 31, 2018	22,321	$ 8.75

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

Restricted Stock

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

Restricted stock award activity for the nine months ended March 31, 2018 is as follows:

	Number of Shares	Weighted Average Fair Value
Outstanding at June 30, 2017	486,584	$ 21.26
Granted	281,152	$ 27.91
Forfeited	(63,287)	$ 22.74
Vested	(242,062)	$ 22.80
Outstanding at March 31, 2018	462,387	$ 24.67

Performance-Based Restricted Stock

The Company also grants performance-based restricted stock awards to certain executives and other management. In August and November 2017, the Company granted an aggregate maximum of 251,479 and 27,140 shares, respectively, that vest based on the Company's total shareholder return relative to total shareholder return of the Company's peer group (a market condition), as measured by the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2017 compared to the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2020. Vesting of these awards will be determined on the date that the Company's Annual Report on Form 10-K for the fiscal year ending June 30, 2020 is filed.

To calculate the estimated fair value of these restricted stock awards with market conditions, the Company uses a Monte Carlo simulation, which uses the expected average stock prices to estimate the expected number of shares that will vest. The Monte Carlo simulation resulted in an aggregate fair value of approximately $3,801, which the Company will recognize as expense using the straight-line method over the period that the awards are expected to vest. Stock-based compensation expense related to an award with a market condition will be recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided.

Performance-based restricted stock awards granted in August 2016 that are outstanding vest based on the Company's total shareholder return relative to total shareholder return of the Company's peer group (a market condition), as measured by the closing prices of the stock of the Company and the peer group members for the 90 trading days

preceding July 1, 2016 compared to the closing prices of the stock of the Company and the peer group members for the 90 trading days preceding July 1, 2019.

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Performance-based restricted stock award activity for the nine months ended March 31, 2018 is as follows:

	Number of Shares	Weighted Average Fair Value
Outstanding at June 30, 2017	318,584	$ 11.97
Granted	278,889	$ 13.63
Forfeited	(66,295)	$ 13.17
Outstanding at March 31, 2018	531,178	$ 12.69

7. Commitment and Contingencies

Operating Leases

The Company leases manufacturing space, equipment and apartments under lease agreements that expire at various dates through March 2020. Rental expenses were $157 and $164 for the three months ended March 31, 2018 and 2017, respectively, and $496 and $485 for the nine months ended March 31, 2018 and 2017, respectively.

Future minimum lease payments under the agreements as of March 31, 2018 are as follows:

Three months ended June 30, 2018	$119
Fiscal 2019	472
Fiscal 2020	353
	$944

Stockholder Securities Litigation

With respect to Shoemaker v. Cardiovascular Systems, Inc. et al., 0:16-cv-00568 (D. Minn.) described in Note 8 of the notes to the consolidated annual financial statements included in the Annual Report on Form 10-K filed by the Company with the SEC on August 24, 2017, in Note 7 of the notes to the consolidated (unaudited) financial statements included in the Quarterly Report on Form 10-Q filed by the Company with the SEC on November 3, 2017, and in Note 7 of the notes to the consolidated (unaudited) financial statements included in the Quarterly Report on Form 10-Q filed by the Company with the SEC on February 9, 2018, the Company filed a motion to dismiss the plaintiffs' amended complaint on August 11, 2017. On January 10, 2018, the court granted the Company's motion to dismiss the amended complaint and dismissed the amended complaint with prejudice.

Other Matters

In the ordinary conduct of business, the Company is subject to various lawsuits and claims covering a wide range of matters including, but not limited to, employment claims and commercial disputes. While the outcome of these matters is uncertain, the Company does not believe there are any significant matters as of March 31, 2018 that are probable or estimable, for which the outcome could have a material adverse impact on its consolidated balance sheets or statements of operations.

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8. Earnings Per Share

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Numerator				
Net income (loss)	$365	$ (1,749)	$(2,025)	$ (2,564)
Income allocated to participating securities	(5)	—	—	—
Net income (loss) available to common stockholders	$360	$ (1,749)	$(2,025)	$ (2,564)
Denominator				
Weighted average common shares outstanding – basic	33,237,352	32,650,974	33,105,174	32,232,409
Effect of dilutive stock options[1]	14,197	—	—	—
Effect of dilutive restricted stock units[2]	318,122	—	—	—
Effect of performance-based restricted stock awards[3]	67,918	—	—	—
Effect of employee stock purchase plan[4]	4,015	—	—	—
Weighted average common shares outstanding – diluted	33,641,804	32,650,974	33,105,174	32,232,409
Earnings per common share – basic	$0.01	$ (0.05)	$(0.06)	$ (0.08)
Earnings per common share – diluted	$0.01	$ (0.05)	$(0.06)	$ (0.08)

(1) At March 31, 2018 and 2017, 22,321 and 106,694 stock options were outstanding, respectively. The effect of the shares that would be issued upon exercise of these options has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2018 and the three and nine months ended March 31, 2017 because those shares are anti-dilutive.

(2) At March 31, 2018 and 2017, 335,869 and 349,430 additional shares of common stock, respectively, were issuable upon the settlement of outstanding restricted stock units. The effect of the shares that would be issued upon settlement of these restricted stock units has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2018 and the three and nine months ended March 31, 2017 because those shares are anti-dilutive.

(3) At March 31, 2018 and 2017, 237,369 and 334,505 performance-based restricted stock awards, respectively, were outstanding. The effect of the shares that would be issued upon vesting of these awards has been excluded from the calculation of diluted loss per share for the nine months ended March 31, 2018 and the three and nine months ended March 31, 2017 because those shares are anti-dilutive.

(4) At March 31, 2018, the Company included the number of shares that would be issued under our employee stock purchase plan based on the aggregate expected amount of withholdings and the average unrecognized compensation expense as assumed proceeds. The effect of these shares has been excluded from the calculation of diluted loss per shares for the nine months ended March 31, 2018 and the three and nine months ended March 31, 2017, because those shares are anti-dilutive.

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

the three months ended March 31, 2018, undistributed earnings allocated to participating securities were based on 462,387 unvested time-based restricted stock awards.

9. Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law. Among other provisions, the Tax Act will lower the Federal statutory corporate income tax rate from 35% to 21%. Under ASC 740, Accounting for Income Taxes, the enactment of the Tax Act requires companies to recognize the effects of changes in tax laws and rates on deferred tax assets and liabilities and the retroactive effects of changes in tax laws in the period in which the new legislation is enacted. The Company has reviewed the provisions that will impact the Company, however, given that its deferred tax assets are offset by a full valuation allowance, the Company does not expect these changes to have a net impact on its financial position and net loss after the revaluation. There is no change to the Company’s assertion on maintaining a full valuation allowance against its deferred tax assets.

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 1 of Part I of this Quarterly Report on Form 10-Q. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy for our business and expected financial results, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" discussed in our Annual Report on Form 10-K for the year ended
June 30, 2017 and subsequent reports on Form 10-Q, including in Item 1A of Part II of this Quarterly Report on Form 10-Q, for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

OVERVIEW

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

Peripheral

Our peripheral arterial disease ("PAD") products, the Diamondback 360® Peripheral Orbital Atherectomy System ("OAS") ("Diamondback 360 Peripheral"), the Diamondback 360 60cm Peripheral OAS, the Diamondback 360 4 French 1.25 Peripheral OAS, the Diamondback 360 1.50 Peripheral OAS, the Diamondback 360 2.00 Peripheral OAS, and the Stealth 360® Peripheral OAS ("Stealth 360"), are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee, including calcified plaque, and address many of the limitations associated with other existing surgical, catheter and pharmacological treatment alternatives. The micro-invasive devices use small access sheaths that can provide procedural benefits and allow physicians to treat PAD patients in even the small and tortuous vessels located below the knee and facilitate access through alternative sites in the ankle, foot and wrist, as well as in the groin. We refer to each of the products above in this report as the "Peripheral OAS."

The United States Food and Drug Administration ("FDA") has granted us 510(k) clearances for our Peripheral OAS devices as a therapy in patients with PAD, as discussed in Item 1 of Part I of our Annual Report on Form 10-K for the year ended June 30, 2017.

In January 2018, we announced that we entered into an original equipment manufacturer agreement with Integer Holdings Corporation for CSI-branded ZILIENT™ guidewires. The broad market launch of the CSI-branded ZILIENT peripheral guidewires is expected to begin later in the current fiscal year. We anticipate that additional ZILIENT guidewires for coronary interventions and radial peripheral interventions will become available in the future.

In February 2018, we announced that the first patients were treated using our FDA-cleared extended length Diamondback 360 Peripheral OAS to treat PAD. Radial access allows physicians to reach and treat lower limb PAD lesions through the radial artery in the wrist, providing an alternative access point and more options to treat complicated and at-risk patients. We are currently in a limited market rollout with an anticipated full commercial launch in fiscal 2019.

Coronary

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

A coronary application required us to conduct a clinical trial and file a premarket approval (“PMA”) application and obtain approval from the FDA. In March 2013, we completed submission of our PMA application to the FDA for our orbital atherectomy system to treat calcified coronary arteries. In October 2013, we received PMA from the FDA to market the Coronary OAS as a treatment for severely calcified coronary arteries. We commenced a commercial launch of our Coronary OAS following receipt of PMA. In March 2017, we received approval from the FDA to market the Diamondback 360 Coronary OAS Micro Crown (the “Coronary OAS Micro Crown”).

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In January 2018, we announced our relationship with OrbusNeich® to be the exclusive U.S. distributor of OrbusNeich balloon products. In March 2018, the FDA granted 510(k) clearance for the OrbusNeich 1.0mm Sapphire® 11 Pro coronary balloon ("1.0mm balloon"). The 1.0mm balloon, the first and only 1.0mm coronary balloon available in the United States, offers industry-leading entry and crossing profiles and is precision engineered for crossing and treating extremely tight and complex lesions. We anticipate OrbusNeich's full balloon product portfolio will become available in the United States in 2018 and 2019.

We market the Peripheral and Coronary OAS and ancillary products in the United States through a direct sales force and expend significant capital on our sales and marketing efforts to expand our customer base and utilization per customer. At our facilities, we assemble the saline infusion pump and the single-use catheter used in the Peripheral and Coronary OAS with components purchased from third-party suppliers, as well as with components manufactured in-house. Ancillary products are purchased from third-party suppliers.

International

In November 2016, we signed an exclusive distribution agreement with Medikit Co., Ltd. ("Medikit") to sell our Coronary and Peripheral OAS in Japan. In March 2017, we received approval from Japan's Ministry of Health, Labor and Welfare for our Coronary OAS Micro Crown. On February 1, 2018, the Coronary OAS Micro Crown received reimbursement approval in Japan, followed by the first commercial sales, making Japan the first international market for any of our products. The Coronary OAS Micro Crown is the only atherectomy device designed to both pilot tight, calcific lesions and treat 2.5 to 4mm vessels with a single device. We are currently evaluating options for additional international markets to expand the coronary and peripheral opportunities.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

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

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

Our critical accounting policies are identified in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017 in Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Critical Accounting Policies and Significant Judgments and Estimates."

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RESULTS OF OPERATIONS

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

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2018	2017	Percent Change	2018	2017	Percent Change
Net revenues	$55,587	$52,144	6.6 %	$157,891	$151,987	3.9 %
Cost of goods sold	9,969	11,139	(10.5)	28,670	29,768	(3.7)
Gross profit	45,618	41,005	11.2	129,221	122,219	5.7
Expenses:						
Selling, general and administrative	37,796	37,332	1.2	110,722	108,191	2.3
Research and development	7,333	5,432	35.0	20,037	16,572	20.9
Total expenses	45,129	42,764	5.5			