Cardiovascular Systems Inc
Form 10-Q
February 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2013
Commission File No. 000-52082

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

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

651 Campus Drive
St. Paul, Minnesota 55112-3495
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code: (651) 259-1600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x
The number of shares outstanding of the registrant's common stock as of January 31, 2014 was: Common Stock, $0.001 par value per share, 30,001,803 shares.

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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)

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

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

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

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

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

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

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

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

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

1. Business Overview

Company Description

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

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

2. Summary of Significant Accounting Policies

Interim Financial Statements

The Company has prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. The year-end consolidated balance sheet was derived from the Company's audited consolidated financial statements, but does not include all disclosures as required by GAAP. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to state fairly the Company's consolidated financial position, the results of its operations and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Form 10-K filed by the Company with the SEC on September 11, 2013. The nature of the Company's business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

Fair Value of Financial Instruments

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

Level 1 Inputs — quoted prices in active markets for identical assets and liabilities

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

Level 3 Inputs — unobservable inputs

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

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

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

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

Use of Estimates

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

Stock-Based Compensation

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

Revenue Recognition

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

3. Selected Consolidated Financial Statement Information

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

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

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

4. Debt

Loan and Security Agreement with Silicon Valley Bank

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

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

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

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Loan and Security Agreement with Partners for Growth

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

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

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

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

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

5. Equity Offering

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

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6. Interest and Other, Net

Interest and other, net, includes the following:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Interest expense, net of premium amortization	$(564)	$(345)	$(845)	$(715)
Interest income	5	6	12	15
Change in fair value of conversion option	—	(276)	(61)	112
Net write-offs upon conversion (option and unamortized premium)	(574)	—	(655)	—
Other	(30)	(30)	(59)	(61)
Total	$(1,163)	$(645)	$(1,608)	$(649)

7. Stock Options and Restricted Stock Awards

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

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

All options granted under the Plans become exercisable over periods established at the date of grant. The option exercise price is generally not less than the estimated fair market value of the Company’s common stock at the date of grant, as determined by the Company’s management and board of directors. In addition, the Company has granted nonqualified stock options to a director outside of the Plans.

As of December 31, 2013, all outstanding options were fully vested. An employee's vested options must be exercised at or within 90 days of termination to avoid forfeiture.

Stock option activity for the six months ended December 31, 2013 is as follows:

	Number of Options(a)	Weighted Average Exercise Price
Options outstanding at June 30, 2013	1,739,663	$9.79
Options exercised	(659,207)	$9.57
Options outstanding at December 31, 2013	1,080,456	$9.81

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

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

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

Restricted stock award activity for the six months ended December 31, 2013 is as follows:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards outstanding at June 30, 2013	1,430,130	$10.78
Restricted stock awards granted	559,134	$17.80
Restricted stock awards forfeited	(54,488)	$11.91
Restricted stock awards vested	(586,408)	$9.73
Restricted stock awards outstanding at December 31, 2013	1,348,368	$14.64

8. Common Stock Warrants

Common stock warrant activity for the six months ended December 31, 2013 is as follows:

	Number of Shares	Weighted Average Exercise Price
Common stock warrants outstanding at June 30, 2013	2,091,718	$8.96
Common stock warrants exercised	(1,105,913)	$8.96
Common stock warrants forfeited or expired	(814)	$61.30
Common stock warrants outstanding at December 31, 2013	984,991	$8.92

Of the 1,105,913 warrants exercised during the six months ended December 31, 2013, 798,651 were cashless transactions resulting in an increase of $3,237 to additional paid-in capital with a corresponding decrease to common stock warrants.

9. Commitment and Contingencies

Operating Leases

The Company leases manufacturing and office space and equipment under various lease agreements which expire at various dates through March 2020. Rental expenses were $682 and $696 for the six months ended December 31, 2013 and 2012, respectively.

Future minimum lease payments under the agreements as of December 31, 2013 are as follows:

Six months ended June 30, 2014	$562
2015	1,138
2016	757
2017	465
2018	460
Thereafter	806
	$4,188

Amounts payable under the Company's Texas production facility lease are included in the amounts above. A portion of those rent payments may reduce the deferred grant incentive liability rather than being recorded as expense. See Note

10 for additional information.

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10. Texas Production Facility

Effective on September 9, 2009, the Company entered into an agreement with the Pearland Economic Development Corporation (the "PEDC") for the construction and lease of an approximately 46,000 square foot production facility located in Pearland, Texas. The facility will primarily serve as an additional manufacturing location for the Company. The Company and the PEDC entered into a Corporate Job Creation Agreement dated June 17, 2009, which was subsequently amended July 2, 2012. The Job Creation Agreement, as amended, provided the Company with $2,975 in net cash incentive funds. The Company believes it will be able to comply with the conditions specified in the amended agreement. The PEDC will provide the Company with an additional $850 of net cash incentive funds in the following amounts and upon achievement of the following milestones:

- $425 upon the hiring of the 75th full-time employee at the facility on or before March 31, 2014, and maintaining 75 employees at the facility through March 31, 2015; and
- $425 upon the hiring of the 125th full-time employee at the facility on or before June 30, 2015, and maintaining 125 employees at the facility through June 30, 2016.

In order to retain all of the cash incentives, the Company must maintain no fewer than 25 jobs at the Texas facility through June 30, 2015. Failure to meet this requirement will result in an obligation to make reimbursement payments to the PEDC as outlined in the amended agreement. The Company will not have any reimbursement requirements after June 30, 2015. As of December 31, 2013, the Company was in compliance with all minimum requirements under the amended agreement. The Company believes it will be able to comply with the conditions specified in the amended agreement.

The Job Creation Agreement, as amended, also provided the Company with a net $1,020 award, of which $510 was received from the PEDC and the remainder is funded through the Texas Enterprise Fund program associated with the State of Texas. As of December 31, 2013, $340 has been received and the remaining $170 will be provided upon the hiring of the 75th full-time employee at the facility. The grant from the State of Texas is subject to reimbursement if the Company fails to meet certain job creation targets through 2014 and maintain these positions through 2020.

The Company has presented the net cash incentive funds as a current and long-term liability on the balance sheet. The liabilities are reduced through the term of the agreement and recorded as an offset to expenditures incurred using a systematic methodology. As of December 31, 2013, the deferred grant incentive liabilities have been reduced by $3,598 in cumulative expenses, resulting in a remaining current liability of $151 and long-term liability of $16.

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11. 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:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Numerator				
Net loss	$(8,658)	$(5,767)	$(15,950)	$(10,977)
Denominator				
Weighted average common shares – basic	27,177,952	20,699,222	25,964,660	20,548,113
Effect of dilutive stock options, warrants, convertible debt (a)(b)(c)	—	—	—	—
Weighted average common shares outstanding – diluted	27,177,952	20,699,222	25,964,660	20,548,113
Net loss per common share — basic and diluted	$(0.32)	$(0.28)	$(0.61)	$(0.53)

(a) At December 31, 2013 and 2012, 984,991 and 2,349,661 warrants, respectively, were outstanding. The effect of the shares that would be issued upon exercise of these warrants has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

(b) At December 31, 2013 and 2012, 1,080,456 and 1,993,368 stock options, respectively, were outstanding. 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 because those shares are anti-dilutive.

(c) At December 31, 2013 and 2012, 0 and 363,794 additional shares of common stock were issuable upon the conversion of outstanding convertible debt agreements. The effect of the shares that would be issued upon conversion of these debt agreements has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

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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. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly 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 Form 10-K for the year ended June 30, 2013 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 device company focused on developing and commercializing interventional treatment systems for vascular disease. Our peripheral arterial disease products, the Stealth 360° PAD System (the "Stealth 360°"), the Diamondback 360° PAD System (the "Diamondback 360°"), and the Diamondback Predator 360° PAD System (the "Predator 360°") are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee and address many of the limitations associated with existing treatment alternatives. We refer to the Stealth 360°, Diamondback 360°, and Predator 360° collectively in this report as the "PAD Systems." We have also obtained approval to market our Diamondback 360® Coronary Orbital Atherectomy System ("CAD System") as a treatment for severely calcified coronary arteries.

Since 1997, we have devoted substantially all of our resources to the development of the PAD Systems and CAD System. From 2003 to 2005, we conducted numerous bench and animal tests in preparation for application submissions to the FDA. We initially focused our testing on providing a solution for coronary in-stent restenosis, but later changed the focus to peripheral artery disease, or PAD. In 2006, we obtained an investigational device exemption from the FDA to conduct our pivotal OASIS clinical trial, which was completed in January 2007. The OASIS clinical trial was a prospective 20-center study that involved 124 patients with 201 lesions.

In August 2007, the FDA granted us 510(k) clearance for the use of the Diamondback 360° as a therapy in patients with PAD. We commenced commercial introduction of the Diamondback 360° in the United States in September 2007. We were granted 510(k) clearance of the Predator 360° in March 2009 and Stealth 360° in March 2011. We market the PAD Systems 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. We assemble at our facilities the saline infusion pump used with our Stealth 360° product and the single-use catheter used in the PAD Systems with components purchased from third-party suppliers, as well as with components manufactured in-house. Supplemental products are purchased from third-party suppliers.

We have developed the CAD System as a treatment for severely calcified coronary arteries. A coronary application required us to conduct a clinical trial and file a premarket application, or PMA, and obtain approval from the FDA. On March 15, 2013, we completed submission of our PMA application to the FDA for our CAD System as a treatment for severely calcified coronary arteries. On October 21, 2013, the FDA granted us PMA approval for the use of the CAD System as a treatment for severely calcified coronary arteries. We commenced a controlled commercial introduction of the CAD System in the United States in late October 2013.

As of December 31, 2013, we had an accumulated deficit of $219.2 million. We expect our losses to continue as we invest in sales, marketing, medical education, clinical studies and product research and development for our next phase of growth in the peripheral market and continue the controlled commercial launch of our CAD System. To date, we have financed our operations primarily from the issuance of common and preferred stock, convertible promissory notes, and debt.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

Our management's discussion and analysis of our financial condition and results of operations are 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, the debt conversion option, 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.

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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.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts, and, for certain line items, the changes between the specified periods expressed as percent increases or decreases:

	Three Months Ended December 31,			Six Months Ended December 31,		
($ in thousands)	2013	2012	Percent Change	2013	2012	Percent Change
Revenues	$32,337	$25,309	27.8 %	$62,103	$48,602	27.8 %
Cost of goods sold	7,313	5,958	22.7	14,177	11,212	26.4
Gross profit	25,024	19,351	29.3	47,926	37,390	28.2
Expenses:						
Selling, general and administrative	27,468	20,418	34.5	52,839	40,441	30.7
Research and development	5,051	4,055	24.6	9,429	7,277	29.6
Total expenses	32,519	24,473	32.9	62,268	47,718	30.5
Loss from operations	(7,495)	(5,122)	46.3	(14,342)	(10,328)	38.9
Interest and other, net	(1,163)	(645)	80.3	(1,608)	(649)	147.8
Net loss	$(8,658)	$(5,767)	50.1	$(15,950)	$(10,977)	45.3

Comparison of Three Months Ended December 31, 2013 with Three Months Ended December 31, 2012

Revenues. Revenues increased by $7.0 million, or 27.8%, from $25.3 million for the three months ended December 31, 2012 to $32.3 million for the three months ended December 31, 2013. This increase was attributable to a $5.8 million, or 26.1%, increase in revenues generated from the sale of PAD Systems, primarily from an increased number of devices sold, partially offset by a 3.7% reduction in average selling prices. Additionally, the sale of CAD systems increased from $0 for the three months ended December 31, 2012 to $388,000 for the three months ended December 31, 2013. The sales of supplemental products and other revenue also increased $838,000, or 27.4%, primarily driven by increased sales of PAD and CAD systems, which the products support, and from additional sales of Asahi guidewires.

Currently, all of our revenues are in the United States; however, we intend to sell internationally in the future and have commenced the process of seeking approval to do so in both Europe and Japan. We expect our revenue to increase as we continue to increase the number of physicians using the devices, increase the usage per physician, introduce new and improved products, generate clinical data, continue the controlled commercial launch of our CAD System, and expand into new geographies.

Cost of Goods Sold. Cost of goods sold increased by $1.4 million, or 22.7%, from $6.0 million for the three months ended December 31, 2012, to $7.3 million for the three months ended December 31, 2013. Cost of goods sold represents the cost of materials, labor and overhead for single-use catheters, guidewires, control units, and other ancillary products. The increase was due to an increase in the quantities of products sold, especially PAD Systems, partially offset by lower indirect costs per unit from higher production volumes. Cost of goods sold for the three months ended December 31, 2013 and 2012 includes $169,000 and $96,000, respectively, for stock-based compensation. Gross margin increased from 76.5% during the three months ended December 31, 2012, to 77.4% for the three months ended December 31, 2013, which was primarily due to the lower indirect costs per unit, partially offset by lower average selling prices and a higher mix of Stealth 360° sales. We expect that gross margin in the remainder of fiscal 2014 will be similar to the three months ended December 31, 2013. Quarterly margin fluctuations could occur based on production volumes, timing of new product introductions, sales mix, pricing changes, or other

unanticipated circumstances.

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Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by $7.1 million, or 34.5%, from $20.4 million for the three months ended December 31, 2012 to $27.5 million for the three months ended December 31, 2013. The increase was due to the expansion of our sales and marketing organization, increased variable compensation, increased medical education programs, higher stock-based compensation and the medical device tax, which became effective January 1, 2013. Selling, general and administrative expenses for the three months ended December 31, 2013 and 2012 include $2.1 million and $1.4 million, respectively, for stock-based compensation. We expect our selling, general and administrative expenses to increase in the future as a result of the costs associated with expanding our sales and marketing organization and medical education and other programs to further commercialize our PAD systems, and expand the controlled commercial launch of our CAD System.

Research and Development Expenses. Research and development expenses increased by $1.0 million, or 24.6%, from $4.1 million for the three months ended December 31, 2012 to $5.1 million for the three months ended December 31, 2013. Research and development expenses relate to specific projects to improve our products or expand into new markets, such as the development of new versions of the PAD and CAD systems, shaft designs, crown designs, and PAD and CAD clinical trials. The increase related mainly to additional product development projects and clinical studies which have begun in fiscal 2014, and the related increase in headcount. Research and development expenses for the three months ended December 31, 2013 and 2012 include $304,000 and $164,000, respectively, for stock-based compensation. As we continue to expand our product portfolio within the market for the treatment of peripheral arteries and expand into the coronary market with a controlled commercial launch of our CAD System, we generally expect to incur quarterly research and development expenses above amounts incurred for the three months ended December 31, 2013. Fluctuations could occur based on the number of projects and studies and the timing of expenditures.

Interest and Other, Net. Interest and other expense, net, increased $518,000, from $645,000 for the three months ended December 31, 2012 to $1.2 million for the three months ended December 31, 2013. The increase was primarily driven by net write-offs upon conversion of $574,000 of convertible debt for the three months ended December 31, 2013 and charges for prepayment of our term loan. There were no write-offs upon conversion or charges for prepayment of our term loan for the three months ended December 31, 2012. Net write-offs upon conversion are the result of the conversion of convertible debt and include the write-off of the debt conversion option and any unamortized debt premium or discount. Charges for prepayment of our term loan are the result of the contractual obligations related to the repayment of our term loan in whole prior to the original maturity date.

Comparison of Six Months Ended December 31, 2013 with Six Months Ended December 31, 2012

Revenues. Revenues increased by $13.5 million, or 27.8%, from $48.6 million for the six months ended December 31, 2012 to $62.1 million for the six months ended December 31, 2013. This increase was attributable to a $11.5 million, or 27.0%, increase in revenues generated from the sale of PAD Systems, primarily from an increased number of devices sold, partially offset by a 3.9% reduction in average selling prices. Additionally, the sale of CAD systems increased from $0 for the six months ended December 31, 2012 to $388,000 for the six months ended December 31, 2013. The sales of supplemental products and other revenue also increased $1.6 million, or 26.9%, primarily driven by increased sales of PAD and CAD systems, which the products support, and from additional sales of Asahi guidewires. Currently, all of our revenues are in the United States; however, we intend to sell internationally in the future and have commenced the process of seeking approval to do so in both Europe and Japan. We expect our revenue to increase as we continue to increase the number of physicians using the devices, increase the usage per physician, introduce new and improved products, generate clinical data, continue the controlled commercial launch of our CAD System, and expand into new geographies.

Cost of Goods Sold. Cost of goods sold increased by $3.0 million, or 26.4%, from $11.2 million for the six months ended December 31, 2012, to $14.2 million for the six months ended December 31, 2013. Cost of goods sold represents the cost of materials, labor and overhead for single-use catheters, guidewires, control units, and other ancillary products. The increase was due to an increase in the quantities of products sold, especially PAD Systems, partially offset by lower indirect costs per unit from higher production volumes. Cost of goods sold for the six months ended December 31, 2013 and 2012 includes $311,000 and $211,000, respectively, for stock-based compensation. Gross margin increased from 76.9% during the six months ended December 31, 2012, to 77.2% for the six months

ended December 31, 2013, which was primarily due to the lower indirect costs per unit, partially offset by lower average selling prices and a higher mix of Stealth 360° sales. We expect that gross margin in the remainder of fiscal 2014 will be similar to the six months ended December 31, 2013. Quarterly margin fluctuations could occur based on production volumes, timing of new product introductions, sales mix, pricing changes, or other unanticipated circumstances.

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Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by $12.4 million, or 30.7%, from $40.4 million for the six months ended December 31, 2012 to $52.8 million for the six months ended December 31, 2013. The increase was due to the expansion of our sales and marketing organization, increased variable compensation, increased medical education programs, higher stock-based compensation and the medical device tax, which became effective January 1, 2013. Selling, general and administrative expenses for the six months ended December 31, 2013 and 2012 include $4.0 million and $2.9 million, respectively, for stock-based compensation. We expect our selling, general and administrative expenses to increase in the future as a result of the costs associated with expanding our sales and marketing organization and medical education and other programs to further commercialize our PAD Systems, and expand the controlled commercial launch of our CAD System.

Research and Development Expenses. Research and development expenses increased by $2.2 million, or 29.6%, from $7.3 million for the six months ended December 31, 2012 to $9.4 million for the six months ended December 31, 2013. Research and development expenses relate to specific projects to improve our products or expand into new markets, such as the development of new versions of the PAD and CAD systems, shaft designs, crown designs, and PAD and CAD clinical trials. The increase related mainly to additional product development projects and clinical studies which have begun in fiscal 2014, and the related increase in headcount. Research and development expenses for the six months ended December 31, 2013 and 2012 include $521,000 and $347,000, respectively, for stock-based compensation. As we continue to expand our product portfolio within the market for the treatment of peripheral arteries and expand into the coronary market with a controlled commercial launch of our CAD System, we generally expect to incur quarterly research and development expenses significantly above amounts incurred for the six months ended December 31, 2013. Fluctuations could occur based on the number of projects and studies and the timing of expenditures.

Interest and Other, Net. Interest and other expense, net, increased $1.0 million, from $649,000 for the six months ended December 31, 2012 to $1.6 million for the six months ended December 31, 2013. The increase was primarily driven by net write-offs upon conversion of convertible debt of $655,000 and changes in the fair value of the debt conversion option of $61,000 for the six months ended December 31, 2013 and charges for the prepayment of our term loan. There were no write-offs upon conversion and $112,000 of income from changes in the fair value of the debt conversion option for the six months ended December 31, 2012. There were no charges for prepayment of our term loan for the six months ended December 31, 2012. Net write-offs upon conversion are the result of the conversion of convertible debt and include the write-off of the debt conversion option and any unamortized debt premium or discount. The change in the fair value of the debt conversion option represents the period to period change in fair value of the debt conversion option associated with outstanding convertible debt. Charges for prepayment of our term loan are the result of the contractual obligations related to the repayment of our term loan in whole prior to the original maturity date.

LIQUIDITY AND CAPITAL RESOURCES

We had cash and cash equivalents of $146.7 million and $67.9 million at December 31, 2013 and June 30, 2013, respectively. During the six months ended December 31, 2013, net cash used in operations amounted to $(12.5) million. As of December 31, 2013, we had an accumulated deficit of $219.2 million. We have historically funded our operating losses primarily from the issuance of common and preferred stock, convertible promissory notes, and debt.

Loan and Security Agreement with Silicon Valley Bank

On March 29, 2010, we entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement was amended on December 27, 2011 to increase the size of the facility, and subsequently amended on June 29, 2012 to modify financial covenants and reduce the interest rate and other fees, and on May 10, 2013 to modify financial covenants. The agreement, as amended, includes a $12.0 million term loan and a $15.0 million line of credit. The terms of each of these loans are as follows:

- The $12.0 million term loan has an initial interest rate of 8.0%, which can be reduced to 7.0% based on the achievement of positive EBITDA for the trailing six month period. The term loan has a 36 month maturity, with repayment terms that include interest only payments during the first six months, followed by 30 equal principal payments of $400,000 plus interest, and a final payment of $100,000 due at maturity. This term loan also includes an acceleration provision that requires us to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0%

of the commitment amount, upon the occurrence and continuance of an event of default. The balance outstanding on the term loan at December 31, 2013 and June 30, 2013 was $0 and $7.0 million, respectively, net of the unamortized discount associated with warrants issued to Silicon Valley Bank in connection with the loan.

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The $15.0 million line of credit expires on June 30, 2014 and has a floating interest rate equal to the Wall Street Journal's prime rate, plus 1.25%, with an interest rate floor of 4.5%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on 85% of eligible accounts. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The line of credit is subject to non-use fees, annual fees, and cancellation fees. The balance outstanding on the line of credit at December 31, 2013 and June 30, 2013 was $4.8 million and $0, respectively. During the quarter ended December 31, 2013, the Company paid the remaining balance on the term loan with funds from the line of credit.

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

Loan and Security Agreement with Partners for Growth

On April 14, 2010, we entered into a loan and security agreement with Partners for Growth III, L.P. (PFG), as amended on August 23, 2011, December 27, 2011, June 30, 2012, and May 10, 2013. The amended agreement provides that PFG will make loans to us up to $5.0 million. The agreement has a maturity date of April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank's prime rate, and such interest is payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by us at any time in whole or in part. As of December 31, 2013, PFG has no outstanding loans provided to us.

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

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

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

The loans are secured by certain of our assets, and the agreement contains customary covenants limiting our ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on its stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of its business. In addition, the PFG loan and security agreement contains financial covenants requiring us to maintain certain liquidity and fixed charge coverage ratios. We were in compliance with all financial covenants at December 31, 2013. If we do not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or

require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

Equity Offering

On November 26, 2013, we sold 3,000,000 shares of its common stock at $30.00 per share in a registered underwritten public offering. Net proceeds to us, after deducting underwriting discounts, commissions, and expenses, were $84.4 million.

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Changes in Liquidity

Cash and Cash Equivalents. Cash and cash equivalents were $146.7 million at December 31, 2013 and $67.9 million at June 30, 2013. The increase is primarily attributable to proceeds from the sale of our common stock, partially offset by net cash used in operations and investing activities during the six months ended December 31, 2013.

Operating Activities. Net cash used in operating activities was $(12.5) million and $(7.3) million for the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013 and 2012, we had a net loss of $(16.0) million and $(11.0) million, respectively. Significant changes in working capital during these periods included:

•Cash (used in) provided by accounts receivable of $(1.4) million and $494,000 during the six months ended December 31, 2013 and 2012, respectively. Cash (used in) provided by accounts receivable was primarily due to a change in the amount and timing of revenue during the six months ended December 31, 2013 and 2012.

•Cash used in inventories of $(4.0) million and $(100,000) during the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013, the amount of cash used in inventories was primarily due to higher levels of finished goods for future sales and timing of inventory purchases and sales. For the six months ended December 31, 2012, cash used in inventories was primarily due to the timing of inventory purchases and sales.

•Cash (used in) provided by prepaid expenses and other assets of $(194,000) and $581,000 during the six months ended December 31, 2013 and 2012, respectively. Cash provided by prepaid expenses and other assets was primarily due to payment timing of vendor deposits and other expenditures.

•Cash provided by (used in) accounts payable of $1.4 million and $(799,000) during the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013 and 2012, cash provided by (used in) accounts payable was due to timing of purchases and vendor payments.

•Cash provided by (used in) accrued expenses and other liabilities of $1.1 million and $(405,000) during the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013 and 2012, cash provided by accrued expenses and other liabilities was primarily due to the amount and timing of compensation payments.

Investing Activities. Net cash used in investing activities was $(1.1) million and $(784,000) for the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013 and 2012, cash used in investing activities entirely related to the purchase of property and equipment and patents.

Financing Activities. Net cash provided by financing activities was $92.4 million and $1.8 million for the six months ended December 31, 2013 and 2012, respectively. For the six months ended December 31, 2013, cash provided by financing activities included proceeds from the issuance of common stock, net of issuance costs, of $84.4 million, proceeds from exercise of stock options and warrants of $9.1 million, and proceeds from employee stock purchases of $1.3 million, partially offset by net payments on long-term debt of $2.4 million. For the six months ended December 31, 2012, cash provided by financing activities consisted of proceeds from exercise of stock options and warrants of $3.4 million, and proceeds from employee stock purchases of $761,000, partially offset by payments on long-term debt of $2.4 million.

Our future liquidity and capital requirements will be influenced by numerous factors, including the extent and duration of future operating losses, the level and timing of future sales and expenditures, the results and scope of ongoing research and product development programs and clinical studies, working capital required to support our sales growth, the receipt of and time required to obtain regulatory clearances and approvals, and market and regulatory developments. As of December 31, 2013, we believe our current cash and cash equivalents and available debt will be sufficient to fund working capital requirements, capital expenditures and operations of our current business strategy for the foreseeable future. We intend to retain any future earnings to support operations and to finance the growth and development of our business, and we do not anticipate paying any dividends in the foreseeable future.

NON-GAAP FINANCIAL INFORMATION

To supplement our consolidated financial statements prepared in accordance with GAAP, our management uses a non-GAAP financial measure referred to as “Adjusted EBITDA.” The following table sets forth, for the periods indicated, a reconciliation of Adjusted EBITDA to the most comparable U.S. GAAP measure expressed as dollar

amounts (in thousands):

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	Six Months Ended December 31,	
	2013	2012
Loss from operations	$(14,342)	$(10,328)
Add: Stock-based compensation	4,855	3,440
Add: Depreciation and amortization	629	447
Adjusted EBITDA	$(8,858)	$(6,441)

The decline in Adjusted EBITDA of $2.4 million, or 37.5%, is primarily the result of an increase in the loss from operations, partially offset by an increase in stock-based compensation. The loss from operations was impacted by increases in operating expenses as discussed above, partially offset by an increase in revenues and gross profit.

Stock-based compensation increased $1.4 million, or 41.1%, from $3.4 million for the six months ended December 31, 2012 to $4.9 million for the six months ended December 31, 2013. Stock-based compensation increased as a result of increased employee stock awards granted due to the expanded hiring, increased vesting of previously granted share awards with a higher grant date fair value, and the granting of performance based restricted stock awards with accelerated vesting periods.

Use and Economic Substance of Non-GAAP Financial Measures Used and Usefulness of Such Non-GAAP Financial Measures to Investors

We use Adjusted EBITDA as a supplemental measure of performance and believe this measure facilitates operating performance comparisons from period to period and company to company by factoring out potential differences caused by depreciation and amortization expense and non-cash charges such as stock-based compensation. Our management uses Adjusted EBITDA to analyze the underlying trends in our business, assess the performance of our core operations, establish operational goals and forecasts that are used to allocate resources and evaluate our performance period over period and in relation to our competitors' operating results. Additionally, our management is partially evaluated on the basis of Adjusted EBITDA when determining achievement of their incentive compensation performance targets.

We believe that presenting Adjusted EBITDA provides investors greater transparency to the information used by our management for its financial and operational decision-making and allows investors to see our results "through the eyes" of management. We also believe that providing this information better enables our investors to understand our operating performance and evaluate the methodology used by our management to evaluate and measure such performance.

The following is an explanation of each of the items that management excluded from Adjusted EBITDA and the reasons for excluding each of these individual items:

- Stock-based compensation. We exclude stock-based compensation expense from our non-GAAP financial measures primarily because such expense, while constituting an ongoing and recurring expense, is not an expense that requires cash settlement. Our management also believes that excluding this item from our non-GAAP results is useful to investors to understand the application of stock-based compensation guidance and its impact on our operational performance, liquidity and ability to make additional investments in the Company, and it allows for greater transparency to certain line items in our financial statements.
- Depreciation and amortization expense. We exclude depreciation and amortization expense from our non-GAAP financial measures primarily because such expenses, while constituting ongoing and recurring expenses, are not expenses that require cash settlement and are not used by our management to assess the core profitability of our business operations. Our management also believes that excluding these items from our non-GAAP results is useful to investors to understand our operational performance, liquidity and ability to make additional investments in the company.

Material Limitations Associated with the Use of Non-GAAP Financial Measures and Manner in Which We Compensate for these Limitations

Non-GAAP financial measures have limitations as analytical tools and should not be considered in isolation or as a substitute for our financial results prepared in accordance with GAAP. Some of the limitations associated with our use of these non-GAAP financial measures are:

- Items such as stock-based compensation do not directly affect our cash flow position; however, such items reflect economic costs to us and are not reflected in our Adjusted EBITDA, and therefore these non-GAAP measures do not reflect the full economic effect of these items.

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- Non-GAAP financial measures are not based on any comprehensive set of accounting rules or principles and therefore other companies may calculate similarly titled non-GAAP financial measures differently than we do, limiting the usefulness of those measures for comparative purposes.
- Our management exercises judgment in determining which types of charges or other items should be excluded from the non-GAAP financial measures we use.

We compensate for these limitations by relying primarily upon our GAAP results and using non-GAAP financial measures only supplementally.

INFLATION

We do not believe that inflation has had a material impact on our business and operating results during the periods presented.

OFF-BALANCE SHEET ARRANGEMENTS

Since inception, we have not engaged in any off-balance sheet activities as defined in Item 303(a)(4) of Regulation S-K.

PRIVATE SECURITIES LITIGATION REFORM ACT

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Such “forward-looking” information is included in this Form 10-Q, including Item 2 of Part I, and in other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company). Forward-looking statements include all statements based on future expectations. This Form 10-Q contains forward-looking statements that involve risks and uncertainties, including coronary use of our products; expected compliance with the conditions specified in our Job Creation Agreement; our expectation that our losses will continue; the expectation of selling our products internationally in the future; our expectation of increased revenue and increased selling, general and administrative expenses; our expectation that gross margin for the remainder of 2014 will be similar to the six months ended December 31, 2013; our plans to continue to expand our sales and marketing efforts; the continued commercial launch of the Diamondback 360® Coronary Orbital Atherectomy System; our expectation that we will incur research and development expenses in future quarters at amounts significantly higher than amounts incurred for the three months ended December 31, 2013; our dividend expectations; and our belief that our current cash and cash equivalents and available debt will be sufficient to fund working capital requirements, capital expenditures and operations for the foreseeable future.

In some cases, you can identify forward-looking statements by the following words: “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “ongoing,” “plan,” “potential,” “predict,” “project,” “should,” “will,” “would,” these terms or other comparable terminology, although not all forward-looking statements contain these words. Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management’s beliefs and assumptions, which in turn are based on their interpretation of currently available information.

These statements involve known and unknown risks, uncertainties and other factors that may cause our results or our industry’s actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. These factors include regulatory developments in the U.S. and foreign countries; FDA clearances and approvals; approval of our products for distribution in foreign countries; approval of products for reimbursement and the level of reimbursement; dependence on market growth; the experience of physicians regarding the effectiveness and reliability of the PAD Systems and Diamondback 360® Coronary Orbital Atherectomy System; the reluctance of physicians and hospitals to accept new products; actual clinical trial and study results; the impact of competitive products and pricing; the effectiveness of the Stealth 360° and Diamondback 360® Coronary Orbital Atherectomy System; unanticipated developments affecting our estimates regarding expenses, future revenues and capital requirements; the difficulty of successfully managing operating costs; our inability to expand our sales and marketing organization; our actual research and development efforts and needs; our ability to obtain and maintain intellectual property protection for product candidates; our actual financial resources and our ability to obtain additional financing; fluctuations in quarterly results; and general economic conditions. These and additional risks and uncertainties are described more fully in our Form 10-K filed with the SEC on September 11,

2013. Copies of filings made with the SEC are available through the SEC's electronic data gathering analysis and retrieval system (EDGAR) at www.sec.gov.

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You should read these risk factors and the other cautionary statements made in this Form 10-Q as being applicable to all related forward-looking statements wherever they appear in this Form 10-Q. We cannot assure you that the forward-looking statements in this Form 10-Q will prove to be accurate. Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. You should read this Form 10-Q completely. Other than as required by law, we undertake no obligation to update these forward-looking statements, even though our situation may change in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary objective of our investment activities is to preserve our capital for the purpose of funding operations, while at the same time maximizing the income we receive from our investments without significantly increasing risk or decreasing availability. To achieve these objectives, our investment policy allows us to maintain a portfolio of cash equivalents and investments in a variety of marketable securities, including money market funds, U.S. government securities, and certain bank obligations. Our cash and cash equivalents as of December 31, 2013 include liquid money market accounts. Due to the short-term nature of these investments, we believe that there is no material exposure to interest rate risk. Our line of credit balance as of December 31, 2013 has a floating interest rate equal to the Wall Street Journal's prime rate, plus 1.25%, with an interest rate floor of 4.5%. We believe that there is no material exposure to interest rate risk related to our line of credit.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, referred to collectively herein as the Certifying Officers, are responsible for establishing and maintaining our disclosure controls and procedures. The Certifying Officers have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act")) as of December 31, 2013. Based on that review and evaluation, which included inquiries made to certain other employees of the Company, the Certifying Officers have concluded that, as of the end of the period covered by this Report, the Company's disclosure controls and procedures, as designed and implemented, are effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, including the important information in the section entitled "Private Securities Litigation Reform Act," you should carefully consider the "Risk Factors" discussed in our Form 10-K for the year ended June 30, 2013 and in our prospectus filed with the SEC on November 21, 2013 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 this report, and materially adversely affect our financial condition or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial might materially adversely affect our actual business, financial condition and/or operating results.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits — See Exhibit Index on page following signatures

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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.

Dated: February 7, 2014

CARDIOVASCULAR SYSTEMS, INC.

By /s/ David L. Martin
David L. Martin
President and Chief Executive Officer
(Principal Executive Officer)

By /s/ Laurence L. Betterley
Laurence L. Betterley
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX
CARDIOVASCULAR SYSTEMS, INC.
FORM 10-Q

Exhibit No.	Description
10.1	Underwriting Agreement between the Company and Merrill Lynch, Pierce, Fenner & Smith Incorporated dated November 20, 2013 (previously filed with the SEC as Exhibit 1.1 to and incorporated herein by reference from the Company's Current Report on Form 8-K filed on November 21, 2013).
10.2 †	Cardiovascular Systems, Inc. Deferred Compensation Plan (previously filed with the SEC as Exhibit 10.1 to and incorporated herein by reference from the Company's Current Report on Form 8-K filed on December 17, 2013).
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of President and Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	Financial statements from the quarterly report on Form 10-Q of the Company for the quarter ended December 31, 2013, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Cash Flows, and (iv) the Notes to Financial Statements.

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* Furnished herewith.
† Compensatory plan or arrangement.