Neos Therapeutics, Inc.
Form 10-Q
August 12, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended JUNE 30, 2016

OR

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

For the transition period from to

Commission File Number 001-37508

Neos Therapeutics, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**2834**	**27-0395455**
State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

2940 N. Hwy 360

Grand Prairie, TX 75050

(972) 408-1300

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

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 o

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 o

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.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares outstanding of the registrant s common stock as of August 10, 2016: 16,070,705 shares.

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NEOS THERAPEUTICS, INC.

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Special note regarding forward-looking statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. We make such forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and other federal securities laws. All statements other than statements of historical facts contained in this Quarterly Report on Form 10-Q are forward-looking statements. In some cases, you can identify forward-looking statements because they contain words such as may, will, should, expects, plans, anticipates, could, intends, target, projects, contemplates, believes, estimates, predicts, potentia negative of these words or other similar terms or expressions that concern our expectations, strategy, plans or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our anticipated cash needs and our estimates regarding our capital requirements and our needs for additional financing;

- our ability to develop and commercialize Adzenys XR-ODT and, if approved, Cotempla XR-ODT, NT-0201, or any other future product or product candidate;

- the timing, cost or other aspects of the commercial launch and future sales of Adzenys XR-ODT and, if approved, Cotempla XR-ODT, NT-0201, or any other future product or product candidate;

- our ability to increase our manufacturing and distribution capabilities for Adzenys XR-ODT and, if approved, Cotempla XR-ODT, NT-0201, or any other future product or product candidate;

- the attention deficit hyperactivity disorder patient market size and market adoption of Adzenys XR-ODT and, if approved, Cotempla XR-ODT or NT-0201, by physicians and patients;

- the therapeutic benefits, effectiveness and safety of Adzenys XR-ODT and, if approved, Cotempla XR-ODT, NT-0201, or any other future product or product candidate;

- our expectations regarding the commercial supply of our Adzenys XR-ODT and, if approved, Cotempla XR-ODT, NT-0201, or any other future products, and our generic Tussionex;

- our ability to receive, and the timing of any receipt of the U.S. Food and Drug Administration, or FDA, approvals, or other regulatory action in the United States and elsewhere, for Cotempla XR-ODT, NT-0201, and any other future product candidate;

- our expectations regarding federal, state and foreign regulatory requirements;

- deficiencies the FDA has identified in its Complete Response Letter and may identify with respect to Cotempla XR-ODT and whether we will be able to address the issues that may relate to those deficiencies;

- the New Drug Application resubmission date for Cotempla XR-ODT and submission date for NT-0201;

- our estimates regarding anticipated expenses, capital requirements and our needs for additional financing;

- our product research and development activities, including the timing and progress of our clinical trials, and projected expenditures;

- issuance of patents to us by the U.S. Patent and Trademark Office and other governmental patent agencies;

- our ability to achieve profitability; and

- our staffing needs.

We caution you that the foregoing list may not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q.

You should not rely upon forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties and other factors described in Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and

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uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. The results, events and circumstances reflected in the forward-looking statements may not be achieved or occur, and actual results, events or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make.

Furthermore, this Quarterly Report on Form 10-Q includes statistical and other industry and market data that we obtained from industry publications and research, surveys and studies conducted by third parties. Industry publications and third party research, surveys and studies generally indicate that their information has been obtained from sources believed to be reliable, although they do not guarantee the accuracy or completeness of such information.

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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS.

Neos Therapeutics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 41,886	$ 90,763
Short-term investments	38,232	
Accounts receivable, net of allowances of $1,138 and $1,039, respectively	5,659	3,903
Inventories	4,427	2,520
Deferred contract sales organization fees	525	
Other current assets	1,207	1,058
Total current assets	91,936	98,244
Property and equipment, net	6,848	5,124
Intangible assets, net	16,360	16,672
Other assets	2,564	2,470
Total assets	$ 117,708	$ 122,510
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 3,299	$ 4,824
Accrued expenses	9,189	3,141
Deferred revenue	2,614	
Current portion of long-term debt	1,745	7,973
Total current liabilities	16,847	15,938
Long-Term Liabilities:		
Long-term debt, net of current portion	58,576	26,271
Earnout liability	257	214
Deferred gain on leaseback	132	547
Deferred rent	1,194	1,166
Total long-term liabilities	60,159	28,198

Stockholders Equity:				
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued or outstanding at June 30, 2016 and December 31, 2015				
Common stock, $0.001 par value, 100,000,000 authorized at June 30, 2016 and December 31, 2015; 16,079,902 and 16,070,705 issued and outstanding at June 30, 2016, respectively; 16,025,155 and 16,015,958 issued and outstanding at December 31, 2015, respectively		16		16
Treasury stock, at cost, 9,197 shares at June 30, 2016 and December 31, 2015		(171)		(171)
Additional paid-in capital		196,757		195,314
Accumulated deficit		(155,938)		(116,785)
Accumulated other comprehensive income		38		
Total stockholders equity		40,702		78,374
Total liabilities and stockholders equity	$	117,708	$	122,510

See notes to condensed consolidated financial statements.

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Neos Therapeutics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Revenues:				
Net product sales	$ 1,485	$ 1,484	$ 4,068	$ 1,912
Cost of goods sold	1,682	1,659	3,954	2,754
Gross (loss) profit	(197)	(175)	114	(842)
Research and development	4,253	2,102	6,594	6,422
Selling and marketing expenses	16,046	602	22,330	928
General and administrative expenses	3,508	1,659	7,058	2,996
Loss from operations	(24,004)	(4,538)	(35,868)	(11,188)
Interest expense, net	(1,508)	(884)	(2,469)	(1,641)
Loss on debt extinguishment	(1,187)		(1,187)	
Other income, net	207	208	414	415
Change in fair value of earnout and warrant liabilities	(47)	(539)	(43)	105
Net loss	(26,539)	(5,753)	(39,153)	(12,309)
Preferred stock accretion to redemption value		(586)		(1,070)
Preferred stock dividends		(544)		(1,083)
Net loss attributable to common stock	$ (26,539)	$ (6,883)	$ (39,153)	$ (14,462)
Weighted average common shares outstanding used to compute net loss per share, basic and diluted	16,050,138	887,397	16,037,728	886,323
Net loss per share of common stock, basic and diluted	$ (1.65)	$ (7.76)	$ (2.44)	$ (16.32)

See notes to condensed consolidated financial statements.

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Neos Therapeutics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$ (26,539)	$ (5,753)	$ (39,153)	$ (12,309)
Other comprehensive (loss) income:				
Net unrealized (loss) gain on short-term investments	(21)		38	
Total other comprehensive (loss) income	$ (21)	$	$ 38	$
Comprehensive loss	$ (26,560)	$ (5,753)	$ (39,115)	$ (12,309)

See notes to condensed consolidated financial statements.

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Neos Therapeutics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Six months Ended June 30, 2016

(In thousands, except shares)

(unaudited)

	Preferred Stock		Common Stock		Treasury Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Total Stockholders
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Income	Equity
Balance, December 31, 2015		**$**	**16,025,155**	**$ 16**	**(9,197)**	**$ (171)**	**$ 195,314**	**$ (116,785)**	**$**	**$ 78,374**
Proceeds from exercise of options and warrants			**54,747**				**13**			**13**
Share-based compensation expense							**1,430**			**1,430**
Net unrealized gain on investments									**38**	**38**
Net loss								**(39,153)**		**(39,153)**
Balance, June 30, 2016		**$**	**16,079,902**	**$ 16**	**(9,197)**	**$ (171)**	**$ 196,757**	**$ (155,938)**	**$ 38**	**$ 40,702**

See notes to condensed consolidated financial statements.

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Neos Therapeutics, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Six Months Ended June 30,	
	2016	**2015**
Cash Flows From Operating Activities:		
Net loss	$ (39,153)	$ (12,309)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation expense	1,430	234
Depreciation and amortization of property and equipment	929	843
Amortization of intangible assets	812	747
Changes in fair value of earnout and warrant liabilities	43	(105)
Amortization of patents	23	12
Amortization of senior debt fees	261	280
Deferred interest on debt	668	198
Loss on debt extinguishment	942	
Gain on sale of equipment	(415)	(416)
Change in deferred rent	28	(17)
Net unrealized gain on short-term investment	38	
Changes in operating assets and liabilities:		
Accounts receivable	(1,756)	(1,729)
Inventories	(1,907)	328
Deferred contract sales organization fees	(525)	
Other current assets	(149)	29
Other assets	(117)	(124)
Accounts payable	(1,525)	(211)
Accrued expenses	6,048	(556)
Deferred revenue	2,614	
Net cash used in operating activities	(31,711)	(12,796)
Cash Flows From Investing Activities:		
Net change in short-term investments	(38,232)	3,000
Capital expenditures	(2,653)	(346)
Intangible asset license	(500)	
Net cash (used in) provided by investing activities	(41,385)	2,654
Cash Flows From Financing Activities:		
Proceeds from Deerfield debt note, net of fees	58,420	
Proceeds from senior debt note		10,000
Payment of senior debt and fee	(26,063)	
Net proceeds from issuance of stock	13	13,801
Payments made on borrowings	(8,151)	(797)
Payments of initial public offering costs		(574)
Net cash provided by financing activities	24,219	22,430

(Decrease) increase in cash and cash equivalents		(48,877)		12,288
Cash and Cash Equivalents:				
Beginning		90,763		13,343
Ending	$	41,886	$	25,631
Supplemental Disclosure of Noncash Transactions:				
Initial public offering costs included in accounts payable and accrued expenses	$		$	558
Issuance of stock warrants	$		$	2,131
Preferred stock dividend	$		$	485
Supplemental Cash Flow Information:				
Interest paid	$	2,787	$	1,106

See notes to condensed consolidated financial statements.

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Neos Therapeutics, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and nature of operations

Neos Therapeutics, Inc., a Delaware corporation, and its subsidiaries (the Company), is a fully integrated pharmaceutical company. The Company has developed a broad, proprietary modified-release drug delivery technology that enables the manufacture of single and multiple ingredient extended-release pharmaceuticals in patient- and caregiver-friendly orally disintegrating tablet and liquid suspension dosage forms. The Company has a pipeline of extended-release pharmaceuticals including one approved product and two proprietary product candidates in late stage development for the treatment of attention deficit hyperactivity disorder (ADHD). Adzenys XR-ODT was approved by the US Food and Drug Administration (the FDA), on January 27, 2016 and launched commercially on May 16, 2016. In addition, the Company manufactures and markets a generic Tussionex (hydrocodone and chlorpheniramine) (generic Tussionex), extended-release liquid suspension for the treatment of cough and upper respiratory symptoms of a cold.

Note 2. Summary of significant accounting policies

Basis of Presentation: The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP), for interim information and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes necessary for a complete presentation of financial position, results of operations, and cash flows. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of results of operations for and financial condition as of the end of the interim period have been included. Results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results for the year ending December 31, 2016 or any period thereafter. The audited consolidated financial statements as of and for the year ended December 31, 2015 included information and footnotes necessary for such presentation and were included in the Neos Therapeutics, Inc. Annual Report on Form 10-K and filed with the SEC on March 18, 2016. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2015.

Principles of consolidation: At June 30, 2016, the consolidated financial statements include the accounts of the Company and its four wholly-owned subsidiaries. At December 31, 2014, Neos Therapeutics, Inc. owned, directly or indirectly, 100% of two of its subsidiaries and 99.9% of the third subsidiary, Neostx, Inc. (NTX). The remaining 0.1% ownership of NTX was held by a third party and all such remaining capital stock was acquired by the Company on June 29, 2015, and NTX was merged with and into the Company. The amounts attributable to the noncontrolling

interest were not material to the consolidated financial statements. On September 16, 2015, the Company established two new wholly-owned subsidiaries, Neos Therapeutics Brands, LLC and Neos Therapeutics Commercial, LLC. All significant intercompany transactions have been eliminated.

Cash equivalents: The Company invests its available cash balances in bank deposits and money market funds. The Company considers highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. The Company maintains deposits in federally insured financial institutions in excess of federally insured limits. Management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institutions in which those deposits are held. The Company s primary objectives for investment of available cash are the preservation of capital and the maintenance of liquidity.

Short-term investments: Short-term investments consist of debt securities that have original maturities greater than three months but less than or equal to one year and are classified as available-for-sale securities. Such securities are carried at estimated fair value, with any unrealized holding gains or losses reported, net of any tax effects reported, as accumulated other comprehensive income, which is a separate component of stockholders equity. Realized gains and losses, and declines in value judged to be other-than-temporary, if any, are included in consolidated results of operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other-than-temporary results in a reduction in fair value charged to earnings in that period, and a new cost basis for the security is established. Dividend and interest income is recognized in other income when earned. The cost of securities sold is calculated using the specific identification method. The Company places all investments with government agencies, or corporate institutions whose debt is rated as investment grade. The Company classifies all available-for-sale marketable securities with maturities greater than one year from the balance sheet date, if any, as non-current assets.

Fair value of financial instruments: The carrying value of the Company s financial instruments, including cash and cash equivalents, accounts receivable, other current assets, accounts payable, accrued expenses, and debt, approximates fair value due to the short-term nature of the instruments and/or the current interest rates payable in relation to current market conditions. The fair value of the Company s short-term investments and its earnout and warrant liabilities are disclosed in Note 4.

Inventories: Inventories are stated at the lower of actual cost including labor and manufacturing overhead (which approximates first-in, first-out) or market, net of a reserve for obsolete inventory. Increases in the reserve are recorded as charges to cost of goods sold.

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Inventories consist of raw materials, work in process, finished goods and deferred cost of goods. Cost of sales includes the cost of inventory sold or reserved, which includes manufacturing and supply chain costs, product shipping and handling costs, and product royalties. The cost of sales associated with the deferred product revenues are recorded as deferred costs, which are included in inventory until such time as the deferred revenue is recognized. As the Company has little experience of obtaining approval for and launching its drug products, the Company treats any pre-launch inventory that is manufactured for clinical trials or other purposes as research and development expense until objective and persuasive evidence exists that regulatory approval has been received and future economic benefit is probable. Therefore, all manufacturing costs for the production of Adzenys XR-ODT incurred after the January 27, 2016 FDA approval date are being capitalized into inventory.

Deferred contract sales organization fees: The Company records fees billed in accordance with its commercial sales organization contract for services not yet performed as deferred contract sales organization fees. Such fees are recorded as selling and marketing expenses when the services are provided.

Intangible assets: Intangible assets subject to amortization, which principally include proprietary modified-release drug delivery technology and the costs to acquire the rights to Tussionex New Drug Application (Tussionex ANDA), are recorded at cost and amortized over the estimated lives of the assets, which primarily range from 10 to 20 years.

Revenue recognition: Revenue is generated from product sales, recorded on a net sales basis. Product revenue is recognized when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) price to the buyer is fixed and determinable; and (4) collectability is reasonably assured. Revenue from sales transactions where the buyer has the right to return the product is recognized at the time of sale only if (1) the price to the buyer is substantially fixed or determinable at the date of sale, (2) the buyer has paid for the product, or the buyer is obligated to pay for the product and the obligation is not contingent on resale of the product, (3) the buyer s obligation to pay would not be changed in the event of theft or physical destruction or damage of the product, (4) the buyer acquiring the product for resale has economic substance apart from that provided by the Company, (5) the Company does not have significant obligations for future performance to directly bring about resale of the product by the buyer, and (6) the amount of future returns can be reasonably estimated.

The Company sells its generic Tussionex and Adzenys XR-ODT to pharmaceutical wholesalers, all subject to rights of return. Pharmaceutical wholesalers buy drug products directly from manufacturers. Title to the product passes upon delivery to the wholesalers, when the risks and rewards of ownership are assumed by the wholesaler (freight on board destination). These wholesalers then resell the product to retail customers such as food, drug and mass merchandisers.

The Company has no sales history for Adzenys XR-ODT and has determined that at this time it cannot reliably estimate expected returns of the product at the time of shipment to wholesalers. Accordingly, the Company defers recognition of revenue on product shipments of Adzenys XR-ODT until the right of return no longer exists, which occurs at the earlier of the time Adzenys XR-ODT units are dispensed through patient

prescriptions or expiration of the right of return. The Company calculates patient prescriptions of Adzenys XR-ODT dispensed using an analysis of third-party information.

Net product sales

Net product sales for the Company s products represent total gross product sales less gross to net sales adjustments. Gross to net sales adjustments include savings offers, prompt payment discounts, wholesaler fees and estimated allowances for product returns, rebates and chargebacks to be incurred on the selling price of the respective product sales. Wholesale distribution fees based on definitive contractual agreements are incurred on the management of these products by wholesalers and are recorded within net sales for generic Tussionex and as deferred wholesale distribution fees in other current assets for Adzenys XR-ODT. The deferred wholesale distribution fees for Adzenys XR-ODT are later recorded within net product sales when revenue associated with those fees is recognized. The Company estimates and records gross to net sales adjustments for product returns, rebates and chargebacks based upon analysis of third-party information, including information obtained from the Company s third party logistics providers (3PLs), with respect to its inventory levels and sell-through to the wholesalers customers, for savings offers from data available from third parties regarding savings offers processed for prescriptions written for the Company s products, and, for generic Tussionex, experience reported by the Company s previous commercialization partners. Due to estimates and assumptions inherent in determining the amount of returns, rebates and chargebacks, the actual amount of returns and claims for rebates and chargebacks may be different from the estimates, at which time reserves would be adjusted accordingly. Wholesale distribution fees and the allowance for prompt pay discounts are recorded at the time of shipment and all other allowances and accruals are recorded in the same period that the related revenue is recognized.

Savings offers

The Company offers savings offers programs for Adzenys XR-ODT to patients covered under commercial payor plans in which the cost of a prescription to such patients is discounted. The Company records the amount redeemed based on information from third-party providers and recognizes the discount as a reduction of revenue in the same period the related revenue is recognized.

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Product returns

Wholesalers contractual return rights are limited to defective product, product that was shipped in error, product ordered by customer in error, product returned due to overstock, product returned due to dating or product returned due to recall or other changes in regulatory guidelines. The return policy for expired product allows the wholesaler to return such product starting six months prior to expiry date to twelve months post expiry date.

Generic Tussionex product returns are estimated based upon data available from sales of the Company s product by its former commercialization partner and from actual experience as reported by retailers. Historical trend of returns will be continually monitored and may result in future adjustments to such estimates. On August 26, 2014, the U.S. Drug Enforcement Agency (DEA) reclassified the Company s generic Tussionex from a Schedule III controlled substance to a Schedule II controlled substance which had the effect of requiring unsold product at the wholesalers and the 3PL to either be relabeled or returned. This new ruling was effective October 6, 2014. As such, the Company established reserves for the estimated returns of such product outstanding at the wholesalers as of October 6, 2014. The Company had no inventory labeled as Schedule III at the 3PL as of the effective date.

Rebates

The Company s products are subject to government-managed Medicare and Medicaid programs whereby discounts and rebates are provided to participating federal and/or state governments. Estimated rebates payable under governmental programs are recorded as a reduction of revenue at the time revenues are recorded. Calculations related to these rebate accruals are estimated based on information from third-party providers. Historical trend of governmental rebates will be continually monitored and may result in future adjustments to such estimates.

Wholesaler Chargebacks

The Company s products are subject to certain programs with wholesalers whereby pricing on products is discounted below wholesaler list price to participating entities. These entities purchase products through wholesalers at the discounted price, and the wholesalers charge the difference between their acquisition cost and the discounted price back to the Company. Chargebacks are accounted for by establishing an accrual in an amount equal to the Company s estimate of chargeback claims at the time of product sale based on information provided by third parties. Due to estimates and assumptions inherent in determining the amount of chargebacks, the actual amount of claims for chargebacks may be different from estimates, which may result in adjustments to such reserves.

Research and development costs: Research and development costs are charged to operations when incurred and include salaries and benefits, facilities costs, overhead costs, raw materials, laboratory and clinical supplies, clinical trial costs, contract services, fees paid to regulatory authorities for review and approval of the Company s product candidates and other related costs.

Income taxes: Income taxes are accounted for using the liability method, under which deferred taxes are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax laws that will be in effect when the differences are expected to reverse.

Management evaluates the Company s tax positions in accordance with guidance on accounting for uncertainty in income taxes. Using that guidance, tax positions initially need to be recognized in the financial statements when it is more likely than not that the position will be sustained upon examination. As of June 30, 2016 and December 31, 2015, the Company had no uncertain tax positions that qualify for either recognition or disclosure in the consolidated financial statements. Tax benefits are recognized when it is more likely than not that a tax position will be sustained during an audit. Deferred tax assets are reduced by a valuation allowance if current evidence indicates that it is considered more likely than not that these benefits will not be realized. At June 30, 2016 and December 31, 2015, based on the level of historical operating results and projections for the taxable income for the future, the Company has determined that it is more likely than not that the deferred tax assets will not be realized. Accordingly, the Company has recorded a valuation allowance to reduce deferred tax assets to zero. The Company may not ever be able to realize the benefit of some or all of the federal and state loss carryforwards, either due to ongoing operating losses or due to ownership changes, which limit the usefulness of the loss carryforwards.

Warrants: The Company accounts for its warrants and other derivative financial instruments as either equity or liabilities based upon the characteristics and provisions of each instrument. Warrants classified as derivative liabilities are recorded on the Company s balance sheet at their fair value on the date of issuance and are revalued at each subsequent balance sheet date, with fair value changes recognized as increases or reductions to other income (expense) in the statements of operations. The Company estimates the fair value of its derivative liabilities using third party valuation analysis that utilizes option pricing models and assumptions that are based on the individual characteristics of the warrants or instruments on the valuation date, as well as assumptions for expected volatility, expected life, yield, and risk-free interest rate. Prior to the closing of the initial public offering (IPO), the Company s warrants for the

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Company s Series C redeemable convertible preferred stock (Series C warrants) were determined to be derivative liabilities and they were revalued at each subsequent balance sheet date. Upon closing the IPO, the Series C warrants issued in conjunction with the Series C redeemable convertible preferred stock (Series C preferred stock) financing were exchanged in a cashless exercise for 947,185 shares of Series C preferred stock which converted into 78,926 shares of the Company s common stock. The remaining Series C warrants issued with the senior debt to purchase 170,000 pre-split shares of Series C preferred stock (Hercules Warrants) were converted into warrants with a term of five years to purchase 70,833 shares of the Company s common stock and the warrant liability was reclassified to Additional Paid in Capital within Stockholders Equity.

Share-based compensation: Share-based compensation awards, including grants of employee stock options and restricted stock and modifications to existing stock options, are recognized in the statement of operations based on their fair values. Compensation expense related to awards to employees is recognized on a straight-line basis, based on the grant date fair value, over the requisite service period of the award, which is generally the vesting term. The fair value of the Company s stock-based awards to employees and directors is estimated using the Black-Scholes option pricing model, which requires the input of subjective assumptions, including (1) the expected stock price volatility, (2) the expected term of the award, (3) the risk-free interest rate and (4) expected dividends. Due to the previous lack of a public market for the trading of its common stock and a lack of company-specific historical and implied volatility data, the Company has, prior to the IPO, historically utilized third party valuation analyses to determine the fair value. After the closing of the Company s IPO, the Company s board of directors has determined the fair value of each share of underlying common stock based on the closing price of the Company s common stock as reported by the NASDAQ Global Market on the date of grant. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Ultimately, the actual expense recognized over the vesting period will only be for those options that vest.

Use of estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

Segment information: Operating segments are defined as components of an enterprise about which separate discrete information is available for evaluation by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment, which is the development, manufacturing and commercialization of pharmaceuticals.

Liquidity: During 2015 and the three and six months ended June 30, 2016, the Company produced operating losses and used cash to fund operations. Management intends to achieve profitability through revenue growth from pharmaceutical products developed with its extended-release technologies. The Company does not anticipate it will be profitable until after the launch of Adzenys XR-ODT or, if approved, one or more of its ADHD product candidates. Management believes the Company presently has sufficient liquidity to continue to operate for at least the next 12 months.

Recent accounting pronouncements: In March 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2016-09, *Compensation Stock Compensation Improvements to Employee Share-Based Payment Accounting (Topic 718).* For public companies, areas of accounting for share-based payment that this ASU was designed to simplify include: the income tax consequences, the accounting policy for forfeitures, the classification of awards as either equity or liabilities and the classification on the statement of cash flows. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2016, including interim periods within those years. The Company is evaluating this ASU and has not determined the effect of this standard on its ongoing financial reporting.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842).* Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: 1) a lease liability, which is a lessee s obligation to make lease payments arising from a lease, measured on a discounted basis; and 2) a right-of-use asset, which is an asset that represents the lessee s right to use, or control the use of, a specified asset for the lease term. The new lease guidance simplified the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those years. The Company is evaluating this ASU and has not determined the effect of this standard on its ongoing financial reporting.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will become effective for the Company on January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. Also, in March 2016 the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* to clarify the implementation guidance on principal versus agent considerations. This ASU states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Also, in April 2016 the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers Identifying Performance Obligations and Licensing* to assist preparers with identifying performance obligations and implementing licensing guidance under the new revenue standard. In April 2016 the FASB issued ASU No. 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards*

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Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting. This ASU rescinds certain SEC Staff Observer comments in the following areas that are codified in Topic 605, Revenue Recognition, and Topic 932, Extractive Activities Oil and Gas, effective upon adoption of Topic 606: revenue and expense recognition for freight services in process; accounting for shipping and handling fees and costs c) accounting for consideration given by a vendor to a customer (including reseller of the vendor s products) and d) accounting for gas-balancing arrangements. In May 2016 the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.* This ASU provides clarifying guidance in certain narrow areas and adds some practical expedients relative to assessing collectability, presentation of taxes collected form customers, noncash consideration, contract modifications at transition, completed contracts at transition and technical corrections. The amendments in ASU 2016-08, 2016-10, 2016-11 and 2016-12 have the same effective date and transition requirements as ASU 2014-09. The Company is evaluating the effect that ASU 2014-09, ASU 2016-08, 2016-10, 2016-11 and 2016-12 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of these standards on its ongoing financial reporting.

From time to time, additional new accounting pronouncements are issued by the FASB or other standard setting bodies and adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards that are not yet effective either are not applicable or will not have a material impact on its financial position or results of operations upon adoption.

Note 3. Net loss per share

Basic net loss per share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common shares and common share equivalents outstanding for the period. Common stock equivalents are only included when their effect is dilutive. Potentially dilutive securities which include redeemable convertible preferred stock, warrants and outstanding stock options under the stock option plan have been excluded from the computation of diluted net loss per share as they would be anti-dilutive. For all periods presented, there is no difference in the number of shares used to compute basic and diluted shares outstanding due to the Company s net loss position.

The following potentially dilutive securities outstanding as of June 30, 2016 and 2015 were excluded from consideration in the computation of diluted net loss per share of common stock for the six months ended June 30, 2016 and 2015, respectively, because including them would have been anti-dilutive:

	June 30,	
	2016	**2015**
	(unaudited)	
Series A Redeemable Convertible Preferred Stock (as converted)		487,494
Series B Redeemable Convertible Preferred Stock (as converted)		1,297,100
Series B-1 Redeemable Convertible Preferred Stock (as converted)		2,275,733
Series C Redeemable Convertible Preferred Stock (as converted)		4,803,492
Series C Redeemable Convertible Preferred Stock Warrants (as converted)	70,833	819,650
Common Stock Warrants		337,133

Stock options	1,909,460	776,910

Note 4. Fair value of financial instruments

Financial instruments are categorized into a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the categorization of the financial instrument is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

Financial assets recorded at fair value on the Company s consolidated balance sheets are categorized as follows:

Level 1: Unadjusted quoted prices for identical assets in an active market.

Level 2: Quoted prices in markets that are not active or inputs that are observable either directly or indirectly for substantially the full-term of the asset. Level 2 inputs include the following:

- Quoted prices for similar assets in active markets.
- Quoted prices for identical or similar assets in nonactive markets.
- Inputs other than quoted market prices that are observable.

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- Inputs that are derived principally from or corroborated by observable market data through correlation or other means.

Level 3: Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. They reflect management s own assumptions about the assumptions a market participant would use in pricing the asset.

The following table presents the hierarchy for the Company s financial instruments measured at fair value on a recurring basis for the indicated dates:

	Fair Value as of June 30, 2016 (unaudited) (in thousands)			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 41,886	$	$	$ 41,886
Short term investments		38,232		38,232
Earnout liability			257	257
	$ 41,886	$ 38,232	$ 257	$ 80,375

	Fair Value as of December 31, 2015 (in thousands)			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 90,763	$	$	$ 90,763
Earnout liability			214	214
	$ 90,763	$	$ 214	$ 90,977

The Company s Level 1 assets include cash and cash equivalents. Cash and cash equivalents include bank deposits, certificates of deposit, money market funds and corporate debt securities with a maturity of 90 days or less whose values are considered to approximate fair value at June 30, 2016 and December 31, 2015 due to the short-term nature of the instruments and/or the current interest rates payable in relation to current market conditions.

The Company s Level 2 assets include short term investments which are classified as available-for-sale securities and have a maturity greater than 90 days, but less than 1 year, with quoted prices in active markets. Level 2 securities primarily consisted of commercial paper and bonds issued by domestic and foreign corporations. The estimated fair values of these securities are determined by third parties using various calculations and valuation techniques that incorporate standard observable inputs and assumptions such as quoted prices for similar assets, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, benchmark securities, bids/offers and other pertinent reference data.

The Company s cash and cash equivalents and short term investments had quoted prices at June 30, 2016 as shown below:

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	Amortized Cost	June 30, 2016 Unrealized Gain / (Loss) (unaudited) (in thousands)	Market Value
Bank deposits and money market funds	$ 38,887	$	$ 38,887
Financial and corporate debt securities	41,193	38	41,231
	$ 80,080	$ 38	$ 80,118

Level 3 liabilities included the fair value of the earnout liability at June 30, 2016 and December 31, 2015. The fair value of the earnout liability was determined using the Monte Carlo method as done previously.

Changes in Level 3 liabilities measured at fair value for the periods indicated were as follows:

	Earnout Liability (in thousands)
Balance at December 31, 2015	$ 214
Change in fair value (unaudited)	(4)
Balance at March 31, 2016 (unaudited)	$ 210
Change in fair value (unaudited)	$ 47
Balance at June 30, 2016 (unaudited)	$ 257

Note 5. Inventories

Inventories at the indicated dates consist of the following:

	June 30, 2016 (unaudited)	December 31, 2015
	(in thousands)	
Raw materials	$ 1,437	$ 1,211
Work in progress	2,076	175
Finished goods	1,011	1,189
Deferred cost of goods sold	175	
Inventory at cost	4,699	2,575
Inventory reserve	(272)	(55)

	$	4,427	$ 2,520

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Note 6. Sale-leaseback transaction

In the aggregate, the Company sold groups of assets for $5.5 million and $795,000 in five separate tranches that occurred in February, July and November 2013, and March 2014, which resulted in a net gains of approximately $2.7 million and $116,000, in the years ended December 31, 2013 and 2014, respectively, and executed capital leases for these assets with repurchase options at the end of each respective lease term. Gains on the transactions are recognized on a straight-line basis over each respective 42-month lease term. For the three months ended June 30, 2016 and 2015, approximately $206,000 and $208,000, respectively, and for the six months ended June 30, 2016 and 2015 approximately $415,000 and $416,000, respectively, of the net gain was recognized in other income on the consolidated statements of operations.

Note 7. Intangible assets, net

Intangible assets, net at the indicated dates consist of the following:

	June 30, 2016 (unaudited)	December 31, 2015
	(in thousands)	
Proprietary modified-release drug delivery technology	$ 15,600	$ 15,600
Tussionex ANDA	4,829	4,829
CPI profit sharing	2,043	2,043
Other	784	284
	23,256	22,756
Accumulated amortization	(6,896)	(6,084)
	$ 16,360	$ 16,672

The $15.6 million of proprietary modified-release drug delivery technology is being amortized over 20 years. Amortization expense of $195,000 was recorded in both the three months ended June 30, 2016 and 2015 and amortization expense of $390,000 was recorded for both the six months ended June 30, 2016 and 2015.

Prior to the August 28, 2014 acquisition of the rights to Tussionex ANDA from Cornerstone Biopharma, Inc. (Cornerstone) and Coating Place, Inc. (CPI), the Company, Cornerstone and CPI shared profits generated by the sale and manufacture of the product under a development and manufacturing agreement, and Cornerstone had commercialization rights to the product. The Company paid $4.2 million to Cornerstone and $90,000 of legal fees to buy out its rights to commercialize and derive future profits from the product and entered into an asset acquisition agreement whereby Cornerstone transferred certain assets associated with the product to the Company. In addition, the Company paid $2.0 million to CPI and $43,000 of legal fees to buy out its rights to future profits from the collaboration and entered into an agreement whereby CPI will continue to supply a component of the product. Additional estimated earnout costs due to Cornerstone of $589,000, recorded at fair value by the Company based upon a valuation provided by a third party valuation firm, were capitalized as part of the purchase price of this intangible asset. This earnout amount was revalued at June 30, 2016, resulting in a $47,000 and $43,000, respectively, increase in the estimated fair value of the earnout which is recorded as expense in other income (expense), net in the Company s consolidated statement of operations for the three and six months ended June 30, 2016. This earnout amount was revalued at June 30, 2015, resulting in a $42,000 increase in the

estimated fair value of the earnout which is recorded in other income (expense), net in the Company s consolidated statement of operations for the three months ended June 30, 2015. The net decrease of $400,000 for the six months ended June 30, 2015 resulted from new information regarding the projected impact of the DEA s reclassification of Tussionex from a Schedule III controlled substance to a Schedule II controlled substance. These two intangible assets have an expected life of ten years and are being amortized on a straight-line basis beginning September 2014. Total amortization expense related to these intangible assets was $172,000 and $171,000, respectively, for each of the three months ended June 30, 2016 and 2015, respectively, and $344,000 and $343,000, for the six months ended June 30, 2016 and 2015, respectively.

Note 8. Other assets

Other assets at the indicated dates consist of the following:

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	June 30, 2016 (unaudited)	December 31, 2015
	(in thousands)	
Patents	$ 2,356	$ 2,273
Deposits	208	197
	$ 2,564	$ 2,470

Patents utilized in the manufacturing of the Company s generic Tussionex product which total $231,000 are being amortized over their expected useful life of 10 years. Patents utilized in the manufacturing of Adzenys XR-ODT which total $459,000 are being amortized over their expected useful life of approximately 16 years, beginning with the PDUFA approval of Adzenys XR-ODT on January 27, 2016. Patent amortization expense of $13,000 and $6,000, was recorded for the three months ended June 30, 2016 and 2015, respectively, and patent amortization expense of $23,000 and $12,000, was recorded for the six months ended June 30, 2016 and 2015, respectively,.

Note 9. Long-term debt

Long-term debt at the indicated dates consists of the following:

	June 30, 2016 (unaudited)	December 31, 2015
	(in thousands)	
Deerfield senior secured credit facility, net of discount of $1,544	$ 58,887	$
Senior debt, net of discount of $1,167		24,895
10% subordinated note payable to a related party		6,994
Capital leases, maturing through August 2017	1,434	2,355
	60,321	34,244
Less current portion	(1,745)	(7,973)
Long-term debt	$ 58,576	$ 26,271

On May 11, 2016, the Company entered into a $60 million senior secured credit facility (Facility) with Deerfield Private Design Fund III, L.P. (66 2/3% of loan) and Deerfield Special Situations Fund, L.P. (33 1/3% of Loan) (Deerfield), as lenders. Principal on the new facility is due in three equal annual installments beginning in May 2019 and continuing through May 2021, with a final payment of principal, interest and all other obligations under the facility due May 11, 2022. Interest is due quarterly beginning in June 2016, at a rate of 12.95% per year. The Company has an option to defer payment of each of the first four interest payments until June 1, 2017. The Company exercised the option to defer the first interest payment, adding such amount to the outstanding loan principal until it is paid on June 1, 2017. In connection with the Facility, the Company paid a $1,350,000 yield enhancement fee to Deerfield, approximately $173,000 of legal costs to the Company s attorneys and $58,000 of legal costs on behalf of Deerfield s attorneys, all of which were recorded as debt discount and amortized over the six-year term of the Facility, using the effective interest method. Borrowings under the Facility are collateralized by substantially all of the Company s assets, except the Company s assets under capital lease, and the Company will maintain cash on deposit of not less than $5 million. Approximately $33 million of the $60 million Facility proceeds was used to prepay the existing $24.3 million principal and $0.1 million of accrued interest related to the

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senior Loan and Security Agreement (LSA), the $1.1 million LSA end of term fee, an LSA prepayment charge of $243,000 and the $5.9 million of principal and $1.3 million of interest on the 10% related party amended and restated subordinated note (the Note) that was issued by the Company to Essex Capital Corporation (Essex), which were otherwise payable in 2016 and 2017.

The Facility, also contains certain customary nonfinancial covenants, including limitations on the Company s ability to transfer assets, engage in a change of control, merge or acquire with or into another entity, incur additional indebtedness and distribute assets to shareholders. Upon an event of default, the lender may declare all outstanding obligations accrued under the Facility to be immediately due and payable, and exercise its security interests and other rights. As of June 30, 2016, the Company was in compliance with the covenants under the Facility

Debt discount amortization for the Facility was calculated using the effective interest rate, charged to interest expense and totaled $36,000 for the three and six months ended June 30, 2016.

Senior debt: In March 2014, the Company entered into the LSA with Hercules Technology III, L.P., (Hercules), which was subsequently amended in August 2014, September 2014, December 2014 and June 2015. As amended, the LSA provided a total commitment of $25.0 million, available in four draws. Borrowings under the LSA were collateralized by substantially all of the Company s assets, except the Company s intellectual property and assets under capital lease. The first draw of $10.0 million, (Tranche 1), was issued during March 2014 and was used in its entirety to repay outstanding principal under a previous credit facility. The second draw of $5.0 million, (Tranche 2), was issued during September 2014. The third draw (Tranche 3) in the amount of $5.0 million was issued in March 2015. In June 2015, the fourth and final draw of $5.0 million, (Tranche 4), was issued prior to meeting the Tranche 4 milestones, which were met in July 2015.

Each draw was to be repaid in monthly installments, comprised of interest-only monthly payments until May 2016, when installments of interest and principal calculated over a thirty-month amortization period commenced. A balloon payment of the entire principal balance outstanding on October 1, 2017 and all accrued but unpaid interest thereunder was due and payable on October 1, 2017. The interest rate was 9% per annum for Tranche 1 and Tranche 4 and 10.5% per annum for Tranche 2 and Tranche 3. An end of term charge of $1.1 million was payable at the earliest to occur of (1) October 1, 2017, (2) the date the Company prepaid its outstanding Secured Obligations, as defined therein, or (3) the date the Secured Obligations became due and payable. As such, the end of term charge of $1.1 million was paid on May 11, 2016 when the Company prepaid its outstanding Secured Obligations, as defined therein.

In connection with the LSA, the Company issued the Hercules Warrants which consisted of 60,000 Series C warrants in March 2014 and 110,000 Series C warrants in September 2014 at the then current price of $5.00 per share. The Hercules Warrants became warrants with a term of five years for the purchase of 70,833 shares of common stock at a price of $12.00 per share upon the closing of the Company s IPO and were therefore reclassified from warrant liability to Additional Paid in Capital within Stockholders Equity.

The fair value of the 60,000 Hercules Warrants issued March 28, 2014 as part of the initial draw-down described above was $124,000 and the residual proceeds of $9,876,000 were allocated to the $10.0 million interest bearing note. The fair value of the 110,000 Hercules Warrants issued September 25, 2014 as part of the second draw-down described above was $248,000 and the residual proceeds of $4,752,000 were allocated to the $5.0 million interest bearing note. The warrants were recorded as a liability with a related debt discount to be amortized as interest over the term of the LSA.

LSA end of term charge amortization totaled $38,000 and $121,000 for the three and six months ended June 30, 2016, respectively, and $76,000 and $151,000 for the three and six months ended June 30, 2015, respectively. LSA debt discount amortization charged to interest expense totaled $33,000 and $104,000 for the three and six months ended June 30, 2016, and $65,000 and $129,000 for the three and six months ended June 30, 2015, respectively. At the end of the three and six months ended June 30, 2015, the Hercules warrant fair values were remeasured and the changes in fair value of approximately $87,000 and $119,000, respectively, were recorded in other income (expense), net in the Company s consolidated statements of operations.

The early prepayment of the LSA resulted in a $1,187,000 loss on debt extinguishment (due to recording the $243,000 LSA prepayment charge, writing off $503,000 of unamortized LSA end of term charge and the $439,000 of unamortized LSA loan cost and expensing the $2,500 of legal fees paid on behalf of Hercules) which is separately shown in the statement of operations for the three and six months ended June 30, 2016.

10% subordinated related party note: The Company had a Note in the aggregate principal amount of $5.9 million that was issued by the Company to Essex which was to mature in March 2017. Interest was to be accrued and added to the principal balance until such time as the Company achieved positive EBITDA for three consecutive months. On July 19, 2014, the interest rate on the Note was reduced to 6% for the period from July 19, 2014 through June 28, 2015 pursuant to an amendment to the Note entered into as consideration for the $128,000 payment made by the Company to Essex as part of the Settlement and Release of Claims Agreement with Essex and a third party (see Note 15). The Company recorded this amendment as a loan modification. On May 11, 2016, the Company prepaid the $5.9 million outstanding aggregate principal and $1,317,000 in accrued and unpaid interest. At December 31,

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2015, the aggregate principal amount of the Note was $5.9 million and $1,059,000 in interest had been accrued through December 31, 2015.

Capital lease obligations to related party: As described in Notes 6 and 15, during the years ended December 31, 2013 and 2014, the Company entered into agreements with a related party for the sale-leaseback of existing and newly acquired assets with a total capitalized cost of $5.5 million and $795,000, respectively, which are classified as capital leases. The approximate imputed interest rate on these leases is 14.5% and interest expense on these leases was $61,000 and $123,000 for the three months ended June 30, 2016 and 2015, respectively, and $139,000 and $261,000 for the six months ended June 30, 2016 and 2015, respectively.

Future principal payments of long-term debt including capital leases are as follows:

Period ending:		**June 30, 2016 (unaudited) (in thousands)**
2017	$	1,745
2018		120
2019		15,000
2020		15,000
2021		15,000
Thereafter		15,000
Future principal payments	$	61,865