NEVRO CORP
Form 10-Q
August 07, 2017
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-36715

Nevro Corp.

(Exact name of registrant as specified in its charter)

Delaware	56-2568057
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1800 Bridge Parkway

Redwood City, CA

(Address of principal executive offices)

94065

(Zip Code)

(650) 251-0005

(Registrant's telephone number, including area code)

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

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

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

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

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

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

As of July 31, 2017 there were 29,443,065 shares of the registrant's common stock, par value $0.001 per share, outstanding.

Nevro Corp.

TABLE OF CONTENTS

PART I—FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Nevro Corp.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and per share data)

	June 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$24,869	$ 41,406
Short-term investments	238,414	234,951
Accounts receivable, net of allowance for doubtful accounts of $1,421 and $1,008 at June 30, 2017 and December 31, 2016, respectively	53,566	52,818
Inventories	87,016	85,221
Prepaid expenses and other current assets	6,428	5,895
Total current assets	410,293	420,291
Property and equipment, net	7,179	7,132
Other assets	2,494	2,354
Restricted cash	806	806
Total assets	$420,772	$ 430,583
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$11,032	$ 16,162
Accrued liabilities	26,022	26,028
Other current liabilities	—	8
Total current liabilities	37,054	42,198
Long-term debt	141,520	138,140
Other long-term liabilities	1,408	1,211
Total liabilities	179,982	181,549
Commitments and contingencies (Note 5)		
Stockholders' equity		
Preferred stock, $0.001 par value, 10,000,000 shares authorized at June 30, 2017 and December 31, 2016; zero shares issued and outstanding at June 30, 2017 and December 31, 2016	—	—
Common stock, $0.001 par value, 290,000,000 shares authorized at June 30, 2017 and December 31, 2016; 29,424,013 and 28,886,862 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	29	29

Additional paid-in capital	488,854	470,869
Accumulated other comprehensive loss	(790)	(678)
Accumulated deficit	(247,303)	(221,186)
Total stockholders' equity	240,790	249,034
Total liabilities and stockholders' equity	$420,772	$ 430,583

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

Nevro Corp.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(unaudited)

(in thousands, except share and per share data)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Revenue	$78,016	$55,400	$146,455	$97,051
Cost of revenue	24,143	18,842	46,214	34,506
Gross profit	53,873	36,558	100,241	62,545
Operating expenses				
Research and development	9,537	8,169	18,236	14,530
Sales, general and administrative	54,274	34,312	104,994	62,955
Total operating expenses	63,811	42,481	123,230	77,485
Loss from operations	(9,938)	(5,923)	(22,989)	(14,940)
Interest income	747	295	1,456	510
Interest expense	(2,454)	(972)	(4,889)	(1,614)
Other income (expense), net	416	(653)	947	(163)
Loss on extinguishment of debt	—	(1,268)	—	(1,268)
Loss before income taxes	(11,229)	(8,521)	(25,475)	(17,475)
Provision for income taxes	381	258	642	592
Net loss	(11,610)	(8,779)	(26,117)	(18,067)
Other comprehensive loss:				
Changes in foreign currency translation adjustment	16	(67)	(206)	(346)
Changes in unrealized gains on short-term investments, net	50	157	94	211
Net change in other comprehensive loss	66	90	(112)	(135)
Comprehensive loss	$(11,544)	$(8,689)	$(26,229)	$(18,202)
Net loss per share, basic and diluted	$(0.40)	$(0.31)	$(0.89)	$(0.64)
Weighted average number of common shares used to compute basic and diluted net loss per share	29,351,414	28,381,253	29,255,990	28,287,855

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

Nevro Corp.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Six Months Ended June 30, 2017	2016
Cash flows from operating activities		
Net loss	$(26,117)	$(18,067)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	1,108	769
Stock-based compensation expense	12,456	6,504
Accretion of discount on short-term investments	(93)	(208)
Non-cash loss on extinguishment of debt	—	1,157
Payment of original issue discount	—	(1,500)
Provision for doubtful accounts	400	259
Write-down of inventory	3,386	1,697
Non-cash interest expense	3,380	411
Unrealized (gains) losses on foreign currency transactions	(1,290)	1,477
Changes in operating assets and liabilities		
Accounts receivable	(470)	(14,945)
Inventories	(4,232)	(8,594)
Prepaid expenses and other current assets	(493)	(3,058)
Other assets	(136)	(389)
Accounts payable	(4,986)	(9,600)
Accrued liabilities	(356)	3,045
Other long-term liabilities	197	112
Net cash used in operating activities	(17,246)	(40,930)
Cash flows from investing activities		
Purchases of short-term investments	(143,014)	(224,215)
Proceeds from sales of short-term investments	5,993	—
Proceeds from maturity of short-term investments	133,745	91,600
Purchases of property and equipment	(1,757)	(1,624)
Net cash used in investing activities	(5,033)	(134,239)
Cash flows from financing activities		
Proceeds from issuance of convertible notes	—	172,500
Convertible notes initial issuance discount and debt issuance costs	—	(5,515)
Proceeds from issuance of warrants	—	33,120
Purchase of convertible note hedges	—	(45,092)
Repayment of debt	—	(19,500)
Minimum tax withholding paid on behalf of employees for net share settlement	(655)	—
Proceeds from issuance of common stock to employees	6,172	3,704
Net cash provided by financing activities	5,517	139,217
Effect of exchange rate changes on cash and cash equivalents	225	(388)
Net decrease in cash and cash equivalents	(16,537)	(36,340)

Cash and cash equivalents		
Cash and cash equivalents at beginning of period	41,406	87,036
Cash and cash equivalents at end of period	$24,869	$50,696
Significant non-cash transactions		
Purchases of property and equipment in accounts payable	$123	$792
Vesting of early-exercised stock options	$7	$27

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

Nevro Corp.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Formation and Business of the Company

Nevro Corp. (the Company) was incorporated in Minnesota on March 10, 2006 to manufacture and market innovative active implantable medical devices for the treatment of neurological disorders initially focusing on the treatment of chronic pain. Subsequently, the Company was reincorporated in Delaware on October 4, 2006 and relocated to California.

Since inception, the Company has incurred net losses and negative cash flows from operations. During the year ended December 31, 2016, the Company incurred a net loss of $31.8 million and used $58.5 million of cash in operations. For the six months ended June 30, 2017, the Company incurred a net loss of $26.1 million and used $17.2 million of cash in operations. At June 30, 2017 and December 31, 2016, the Company had an accumulated deficit of $247.3 million and $221.2 million, respectively. The Company has financed operations to date primarily through private placements of equity securities, borrowings under a debt agreement, the issuance of common stock in its November 2014 initial public offering, its June 2015 underwritten public offering and its June 2016 underwritten public offering of convertible senior notes due 2021. The Company's ability to continue to meet its obligations and to achieve its business objectives for the foreseeable future is dependent upon, amongst other things, generating sufficient revenues and its ability to continue to control expenses. Failure to increase sales of its products, manage discretionary expenditures or raise additional financing, if required, may adversely impact the Company's ability to achieve its intended business objectives.

The accompanying interim condensed consolidated financial statements as of June 30, 2017 and for the six months ended June 30, 2017 and 2016, and the related interim information contained within the notes to the financial statements, are unaudited. The unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP) for interim financial information and on the same basis as the audited financial statements included on the Company's Annual Report on Form 10-K (Annual Report) filed with the Securities and Exchange Commission (SEC) on February 23, 2017. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to state fairly the Company's financial position as of June 30, 2017, and the results of its operations and cash flows for the six months ended June 30, 2017 and 2016. All such adjustments are of a normal and recurring nature. The interim financial data as of June 30, 2017 is not necessarily indicative of the results to be expected for the year ending December 31, 2017, or for any future period.

The accompanying condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and the related notes thereto for the year ended December 31, 2016 included in the Annual Report.

2. Summary of Significant Accounting Policies

Basis of Presentation

These condensed consolidated financial statements have been prepared in accordance with U.S. GAAP. The condensed consolidated financial statements include the Company's accounts and those of its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Segments

The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a consolidated basis, accompanied by information about revenue by geographic region, for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the consolidated unit level, other than revenue. Accordingly, the Company has determined that it has a single reportable and operating segment structure. The Company and its Chief Executive Officer evaluate performance based primarily on revenue in the geographic locations in which the Company operates.

Revenue by geography is based on the billing address of the customer. The United States was the only country with revenue accounting for more than 10% of the total revenue in any of the periods presented, as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
United States	81%	73 %	79%	72 %

Long-lived assets and operating income located outside the United States are not material; therefore, disclosures have been limited to revenue.

Foreign Currency Translation

The Company's consolidated financial statements are prepared in U.S. dollars (USD). Its foreign subsidiaries use their local currency as their functional currency and maintain their records in the local currency. Accordingly, the assets and liabilities of these subsidiaries are translated into USD using the current exchange rates in effect at the balance sheet date and equity accounts are translated into USD using historical rates. Revenues and expenses are translated using the monthly average exchange rates during the period when the transaction occurs. The resulting foreign currency translation adjustments from this process are recorded in accumulated other comprehensive income (loss) on the consolidated balance sheets.

Unrealized foreign exchange gains and losses from the remeasurement of assets and liabilities denominated in currencies other than the functional currency of the reporting entity are recorded in other income (expense), net. Additionally, realized gains and losses resulting from transactions denominated in currencies other than the local currency are recorded in other income (expense), net in the condensed consolidated statements of operations. The Company recorded net unrealized and net realized foreign currency transaction gains (losses) during the periods presented as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net unrealized foreign currency gain (loss)	$465	$(1,224)	$1,315	$(1,278)
Net realized foreign currency gain (loss)	(3)	613	(264)	1,228

As the Company's international operations grow, its risks associated with fluctuations in currency rates will become greater, and the Company will continue to reassess its approach to managing this risk. In addition, currency fluctuations or a weakening USD can increase the costs of the Company's international expansion. To date, the Company has not entered into any foreign currency hedging contracts. Based on its current international structure, the Company does not plan on engaging in hedging activities in the near future.

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Significant accounting estimates and management judgments reflected in the condensed consolidated financial statements include items such as allowances for doubtful accounts; warranty obligations; clinical accruals; stock-based compensation; depreciation and amortization periods; inventory valuation; and valuation of investments and deferred tax assets, including valuation allowances. Estimates are based on historical experience, where applicable, and other assumptions believed to be reasonable by the management. Actual results may differ from those estimates under different assumptions or conditions.

Concentration of Credit Risk and Other Risks and Uncertainties

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents and investments. The majority of the Company's cash is held by one financial institution in the United States and is in excess of federally insured limits. The Company maintained investments in money market funds that were not federally insured during the periods ended June 30, 2017 and December 31, 2016. The Company also held cash in foreign banks of approximately $3.6 million at June 30, 2017 and $3.3 million at December 31, 2016 that was not federally insured. The Company has not experienced any losses on its deposits of cash and cash equivalents.

In the international markets in which the Company participates, the Company uses both a direct sales force and distributors to sell its products, while in the United States the Company utilizes a direct sales force. The Company performs ongoing credit evaluations of its direct customers and distributors, does not require collateral, and maintains allowances for potential credit losses on customer accounts when deemed necessary.

During the three and six months ended June 30, 2017 and 2016, no single customer accounted for 10% or more of the Company's revenue. As of June 30, 2017 and December 31, 2016, no single customer accounted for 10% or more of the accounts receivable balance.

The Company is subject to risks common to medical device companies, including, but not limited to, new technological innovations, dependence on key personnel, protection of proprietary technology, compliance with government regulations, product liability, manufacturing quality and scaling, continued reimbursement from third-party payors, uncertainty of market acceptance of products and the need to obtain additional financing. The Company is dependent on third-party manufacturers and suppliers, which, in some cases, are sole- or single-source suppliers.

There can be no assurance that the Company's products or services will continue to be accepted in its existing marketplaces, nor can there be any assurance that any future products or services can be developed or manufactured at an acceptable cost and with appropriate performance characteristics, or that such products or services will be successfully marketed, if at all.

The Company may choose to raise additional funds to further enhance its research and development efforts, for product expansion opportunities or to acquire a new business or products that are complementary to its business. There can be no assurance that such financing will be available or will be at terms acceptable by the Company.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's financial instruments, including cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, approximate fair value due to their relatively short maturities.

Cash and Cash Equivalents

The Company considers all highly-liquid investments purchased with an original maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents include money market funds in the amount of $17.3 million and $35.5 million as of June 30, 2017 and December 31, 2016, respectively. At June 30, 2017 and December 31, 2016, the Company's cash equivalents were held at institutions in the United States and include deposits in a money market fund which was unrestricted as to withdrawal or use.

Restricted Cash

Restricted cash as of June 30, 2017 and December 31, 2016 consists of a letter of credit of $0.6 million representing collateral for the Company's Redwood City, California building lease pursuant to an agreement dated March 5, 2015 and certificates of deposit of $0.2 million collateralizing payment of charges related to the Company's credit cards.

Investment Securities

The Company classifies its investment securities as available-for-sale. Those investments with original maturities greater than three months at the date of purchase and remaining maturities of less than 12 months are considered short-term investments. Those investments with remaining maturities greater than 12 months at the date of purchase are also classified as short-term investments as management considers them to be available for current operations if needed. The Company's investment securities classified as available-for-sale are recorded at fair value. Unrealized gains and losses, deemed temporary in nature, are reported as a separate component of accumulated comprehensive income (loss).

A decline in the fair value of any security below cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security. Premiums (discounts) are amortized (accreted) over the life of the related security as an adjustment to yield using the straight-line interest method. Dividend and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Inventories

Inventories are stated at the lower of cost to purchase or manufacture the inventory or the net realizable value of such inventory. Cost is determined using the standard cost method which approximates the first-in, first-out basis. Net realizable value is determined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The Company regularly reviews inventory quantities in consideration of actual loss experiences, projected future demand and remaining shelf life to record a provision for excess and obsolete inventory when appropriate.

The Company writes down inventory that has become obsolete, inventory that has a cost basis in excess of its expected net realizable value, and inventory that is in excess of expected requirements. The estimate of excess quantities is subjective and primarily dependent on the Company's estimates of future demand for a particular product. If the estimate of future demand is inaccurate based on actual sales, the Company may increase the write down for excess inventory for that component and record a charge to inventory impairment in the accompanying consolidated statements of operations and comprehensive loss. The Company periodically evaluates the carrying value of inventory on hand for potential excess amounts over demand using the same lower of cost or net realizable value approach that has been used to value inventory. The Company also periodically evaluates inventory quantities in consideration of actual loss experience. In addition, the Company determines at times that there may be certain inventory that does not meet its product requirements. As a result of these evaluations, the Company recognized total write downs of $1.3 million and $0.7 million of its inventories for the three months ended June 30, 2017 and 2016, respectively, and $3.4 million and $1.7 million for the six months ended June 30, 2017 and 2016, respectively. The Company's estimation of the future demand for any given particular component of the Senza product may vary and may result in changes in estimates of inventory values in any particular period.

Shipping and Handling Costs

Shipping and handling costs are expensed as incurred and are included in cost of revenue.

Revenue Recognition

The Company recognizes revenue when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- the sales price is fixed or determinable;
- collection of the relevant receivable is reasonably assured at the time of sale; and
- delivery has occurred or services have been rendered.

For a majority of sales, where the Company's sales representative delivers its product at the point of implantation at hospitals or medical facilities, the Company recognizes revenue upon completion of the procedure and authorization, which represents satisfaction of the required revenue recognition criteria. For the remaining sales, which are sent from the Company's distribution centers directly to hospitals and medical facilities, as well as distributor sales, where product is ordered in advance of an implantation procedure and a valid purchase order has been received, the Company recognizes revenue at the time of shipment of the product, which represents the point in time when the customer has taken ownership and assumed the risk of loss and the required revenue recognition criteria are satisfied. The Company's customers are obligated to pay within specified terms regardless of when or if they ever sell or use the products. The Company does not offer rights of return or price protection and it has no post-delivery obligations.

Allowance for Doubtful Accounts

The Company makes estimates of the collectability of accounts receivable. In doing so, the Company analyzes historical bad debt trends, customer credit worthiness, current economic trends and changes in customer payment patterns when evaluating the adequacy of the allowance of doubtful accounts.

Warranty Obligations

The Company has a limited one- to five-year warranty to most customers and warrants that its products will operate substantially in conformity with product specifications. The Company records an estimate for the provision for warranty claims in cost of revenue when the related revenues are recognized. The estimate is based on historical and anticipated rates of warranty claims, the cost per claim and the number of units sold. The Company regularly assesses the adequacy of its recorded warranty obligations and adjusts the amounts as necessary.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment, other than leasehold improvements, is computed using the straight-line method over the assets' estimated useful lives of three to five years. Leasehold improvements are amortized on a straight-line basis over the shorter of the estimated useful life of the asset or the life of the lease. Upon retirement or sale, the cost and related accumulated depreciation are removed from the consolidated balance sheet and the resulting gain or loss, if any, is reflected in operations. Maintenance and repairs are charged to operations as incurred.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group might not be recoverable. When such an event occurs, management determines whether there has been impairment by comparing the anticipated undiscounted future net cash flows to the related asset group's carrying value. If an asset is considered impaired, the asset is written down to fair value, which is based either on discounted cash flows or appraised value, depending on the nature of the asset. There were no impairment charges or changes in estimated useful lives recorded through June 30, 2017.

Income Taxes

During the three and six months ended June 30, 2017 and 2016, the Company calculated its interim tax provision to record taxes incurred on a discrete basis due to the variability of taxable income in the jurisdictions in which it operates. The provision for income taxes for the three and six months ended June 30, 2017 and 2016 is primarily comprised of foreign and state taxes based upon income earned during the period with no tax benefit recorded for the loss jurisdictions.

The Company records uncertain tax positions on the basis of a two-step process whereby (1) a determination is made as to whether it is more likely than not that the tax positions will be sustained based on the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is greater than 50% likely to be realized upon ultimate settlement with the related tax authority. The Company's policy is to recognize interest and penalties related to income taxes as a component of income tax expense. No interest or penalties related to income taxes have been recognized in the statements of operations and comprehensive loss for the three and six months ended June 30, 2017 and 2016.

Comprehensive Income (Loss)

Comprehensive income (loss) represents all changes in the stockholders' equity except those resulting from distributions to stockholders. The Company's changes in unrealized gains and losses on available-for-sale investment securities and foreign currency translation adjustments represent the components of other comprehensive income (loss) that are excluded from the reported net loss and have been presented in the consolidated statements of operations and comprehensive loss.

Research and Development

Research and development costs, including new product development, regulatory compliance and clinical research, are charged to operations as incurred in the consolidated statements of operations and comprehensive loss. Such costs include personnel-related costs, including stock-based compensation, supplies, services, depreciation, allocated facilities and information services, clinical trial and related clinical manufacturing expenses, fees paid to investigative sites and other indirect costs.

Stock-Based Compensation

The Company accounts for stock-based compensation arrangements with employees in accordance with Accounting Standards Codification (ASC) 718, Compensation - Stock Compensation. ASC 718 requires the recognition of compensation expense, using a fair value-based method, for costs related to all share-based payments including stock options.

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Stock Compensation (Topic 718): Improvements to Employee Shared-Based Payment Accounting, which the Company adopted on January 1, 2017. Under ASU 2016-09, entities are permitted to make an accounting policy election to either estimate forfeitures on share-based payment awards, as previously required, or to recognize forfeitures as they occur. The Company has elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost recognized in each period. ASU 2016-09 also requires that entities recognize, on a prospective basis, all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement as discrete items in the reporting period in which they occur. The adoption did not result in a cumulative-effect adjustment to accumulated deficit as of January 1, 2017 using the modified retrospective method. Additionally, under ASU 2016-09, excess tax benefits are classified as an operating activity in the statement of cash flows. The Company has elected the presentation of excess tax benefits in the statement of cash flows using the prospective transition method.

The Company's determination of the fair value of stock options on the date of grant utilizes the Black-Scholes option-pricing model and is impacted by its common stock price as well as changes in assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, expected term that options will remain outstanding, expected common stock price volatility over the term of the option awards, risk-free interest rates and expected dividends.

The fair value is recognized over the period during which an optionee is required to provide services in exchange for the option award, known as the requisite service period (usually the vesting period) on a straight-line basis. Stock-based compensation expense recognized at fair value includes the impact of estimated forfeitures. The Company estimates future forfeitures at the date of grant and revises the estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Equity instruments issued to non-employees are recorded at their fair value on the measurement date and are subject to periodic adjustments as the underlying equity instruments vest. The fair value of options granted to consultants is expensed when vested. The non-employee stock-based compensation expense was not material for all periods presented.

Estimating the fair value of equity-settled awards as of the grant date using valuation models, such as the Black-Scholes option pricing model, is affected by assumptions regarding a number of complex variables. Changes in the assumptions can materially affect the fair value and ultimately how much stock-based compensation expense is recognized. These inputs are subjective and generally require significant analysis and judgment to develop. For all stock options granted to date, the Company estimated the volatility data based on a study of publicly traded industry peer companies. For purposes of identifying these peer companies, the Company considered the industry, stage of development, size and financial leverage of potential comparable companies. The risk-free interest rate is based on the yield available on U.S. Treasury zero-coupon issues similar in duration to the expected term of the equity-settled award.

The Company accounts for stock-based compensation for restricted stock units at their fair value, based on the closing market price of the Company’s common stock on the grant date. These costs are recognized on a straight-line basis over the requisite service period, which is generally the vesting term of four years.

The Company also issues stock options and restricted stock units with vesting based upon completion of performance goals. The fair value for these performance-based awards is recognized over the period during which the goals are to be achieved. Stock-based compensation expense recognized at fair value includes the impact of estimated probability that the goals would be achieved, which is assessed prior to the requisite service period for the specific goals.

Upon adoption of ASU 2016-09 as described above, excess tax benefits or deficiencies from share-based award activity are reflected in the consolidated statements of operations as a component of the provision for income taxes, whereas they were previously recognized as additional paid-in capital.

Net Loss per Share of Common Stock

Basic net loss per common share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the period, without consideration for potentially dilutive securities. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common shares and potentially dilutive securities outstanding for the period. For purposes of the diluted net loss per share calculation, the Company’s restricted stock units and options to purchase shares of common stock are considered to be potentially dilutive securities. Because the Company has reported a net loss in all periods presented, diluted net loss per common share is the same as basic net loss per common share for those periods.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of 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. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments, changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In March 2016, the FASB amended the principal-versus-agent implementation guidance and illustrations in the new standard. In April 2016, the FASB amended the guidance related to identifying performance obligations and the implementation guidance on licensing. In May 2016, the FASB issued guidance related to disclosures of remaining performance obligations, as well as other amendments to guidance on collectability, non-cash consideration and the presentation of sales and other similar taxes collected from customers. ASU 2014-09 and the related amendments (collectively, the new revenue standard) may be applied retrospectively to each prior period presented (full retrospective) or retrospectively with the cumulative effect recognized as of the date of initial application (modified retrospective). The Company currently anticipates adopting the new revenue standard using the modified retrospective approach in the first quarter of 2018. The Company has developed a project plan and has established steering and working committees for the implementation of the guidance. Although the Company is still in the process of evaluating the full impact the new revenue standard will have on its consolidated financial statements, the Company does not expect the impact to be material, as the majority of the Company's revenue arrangements generally consists of a single performance obligation and the transfer of promised goods or services that allows the Company to recognize revenue at a point in time. However, assuming all other revenue recognition criteria have been met, the Company may recognize revenue earlier for arrangements where certain documents needed for revenue recognition under the current standard is considered administrative and incidental under the new revenue standard. As the Company continues its evaluation of the new revenue standard, new information may arise that could change the Company’s current understanding of the impact to revenue and expenses to be recognized under the new revenue standard. The Company will adjust its assessment and implantation plans accordingly.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company has not determined the potential effects of this ASU on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This update requires an entity to recognize assets and liabilities for leases with lease terms of more than 12 months on the balance sheet. ASU 2016-02 is effective for public entities for fiscal years beginning after December 15, 2018. Although the Company is currently evaluating the impact of this guidance on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This update changes the accounting for recognizing impairments of financial assets, such that credit losses for certain types of financial instruments will be estimated based on expected losses. The update also modifies the impairment models for available-for-sale debt securities and for purchased financial assets with credit deterioration since their origination. ASU 2016-13 is effective for public entities for annual periods beginning after December 15, 2019. Early adoption is permitted after December 15, 2018. The Company has not determined the potential effects of this ASU on its consolidated financial statements.

In August, 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). The update clarifies the classification of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of contingent consideration arising from a business combination, insurance settlement proceeds and distributions from certain equity method investees. ASU 2016-15 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company has not determined the potential effects of the guidance on its consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory. This update is intended to reduce the complexity and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers. Under this ASU, a selling entity is required to recognize a current tax expense or benefit upon the transfer of the asset. Similarly, the purchasing entity is required to recognize a deferred tax asset or liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. This ASU does not apply to intra-entity transfers of inventory, where the income tax consequences from the sale of inventory from one member of a consolidated entity to another will continue to be deferred until the inventory is sold to a third party. ASU 2016-16 is effective for public entities for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. The Company has not determined the potential effects of the guidance on its consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, a consensus of the FASB Emerging Issues Task Force. The update requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is effective for public entities for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The Company has not determined the potential effects of the guidance on its consolidated financial statements.

In February 2017, the FASB issued ASU No. 2017-05, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. This update clarifies that a financial asset is within the scope of Subtopic 610-20 if it is deemed an "in substance non-financial asset." The effective date and transition methods of ASU 2017-05 are aligned with ASU 2014-09 described above. The Company has not determined the potential effects of the guidance on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This update shortens the premium amortization period for certain purchased callable debt securities held at a premium. ASU 2017-08 is effective for public entities for annual periods beginning after December 15, 2018. The Company has not determined the potential effects of the guidance on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting. This update amends the scope of modification accounting for share-based payment awards. Specifically, companies would not apply modification accounting if the fair value, vesting conditions and classification of the award remain the same despite a change in terms or conditions. ASU 2017-09 is effective for public entities for annual periods beginning after December 15, 2017, with early adoption permitted. The Company has not determined the potential effects of the guidance on its consolidated financial statements and is currently expecting to adopt the new guidance effective January 1, 2018.

3. Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or an exit price paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair value hierarchy defines a three-level valuation hierarchy for disclosure of fair value measurements as follows:

- Level 1—Observable inputs, such as quoted prices in active markets for identical assets or liabilities.
- Level 2—Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Cash Equivalents and Short-Term Investments

The Company's cash equivalents are comprised of investments in money market funds that are classified as Level 1 of the fair value hierarchy. The Company's money market funds are classified within Level 1 of the fair value hierarchy and are valued based on quoted prices in active markets for identical securities. The Company's short-term investments are comprised of commercial paper and corporate notes. All short-term investments have been classified within Level 1 or Level 2 of the fair value hierarchy because of the sufficient observable inputs for revaluation. The Company's Level 2 investments are valued using third-party pricing sources. The pricing services utilize industry-standard valuation models, including both income and market-based approaches, for which all significant inputs are observable, either directly or indirectly, to estimate fair value. These inputs include reported trades of and broker/dealer quotes on the same or similar investments, issuer credit spreads, benchmark investments, prepayment/default projections based on historical data and other observable inputs. The following table sets forth the Company's financial instruments that were measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

Balance as of June 30, 2017	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds (i)	$17,284	$—	$ —	$17,284
Commercial paper (ii)	—	115,500	—	115,500
Corporate notes (ii)	—	122,914	—	122,914
Total assets	$17,284	$238,414	$ —	$255,698

Balance as of December 31, 2016

Level 1	Level 2