Penumbra Inc
Form 10-Q
August 08, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x 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
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: 001-37557

Penumbra, Inc.
(Exact name of registrant as specified in its charter)

Delaware	05-0605598
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Penumbra Place Alameda, CA	94502
(Address of principal executive offices)	(Zip code)

(510) 748-3200
(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: 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 a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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

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

As of July 18, 2017, the registrant had 33,772,018 shares of common stock, par value $0.001 per share, outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Penumbra, Inc.
Condensed Consolidated Balance Sheets
(unaudited)
(in thousands)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$76,576	$ 13,236
Marketable investments	142,068	115,517
Accounts receivable, net of doubtful accounts of $949 and $684 at June 30, 2017 and December 31, 2016, respectively.	48,714	43,335
Inventories	81,141	73,012
Prepaid expenses and other current assets	14,399	18,727
Restricted cash	1,819	—
Total current assets	364,717	263,827
Property and equipment, net	24,419	21,464
Deferred taxes	22,496	22,476
Other non-current assets	5,371	487
Total assets	$417,003	$ 308,254
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$4,334	$ 4,110
Accrued liabilities	33,177	31,690
Total current liabilities	37,511	35,800
Deferred rent	5,682	5,083
Other non-current liabilities	832	824
Total liabilities	44,025	41,707
Commitments and contingencies (Note 5)		
Stockholders’ equity:		
Common stock	33	31
Additional paid-in capital	384,965	273,865
Accumulated other comprehensive loss	(4,695)	(4,688)
Accumulated deficit	(7,325)	(2,661)
Total stockholders’ equity	372,978	266,547
Total liabilities and stockholders’ equity	$417,003	$ 308,254

See accompanying notes to the unaudited condensed consolidated financial statements

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Penumbra, Inc.
Condensed Consolidated Statements of Operations and Comprehensive (Loss) Income
(unaudited)
(in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue	$80,589	$65,106	$153,802	$123,025
Cost of revenue	29,660	23,636	55,164	41,650
Gross profit	50,929	41,470	98,638	81,375
Operating expenses:				
Research and development	8,094	6,264	15,128	11,265
Sales, general and administrative	44,163	35,876	86,884	68,945
Total operating expenses	52,257	42,140	102,012	80,210
(Loss) income from operations	(1,328)	(670)	(3,374)	1,165
Interest income, net	624	559	1,268	1,069
Other expense, net	(372)	(272)	(721)	(496)
(Loss) income before income taxes	(1,076)	(383)	(2,827)	1,738
Provision for (Benefit from) income taxes	482	(3,396)	1,837	(3,566)
Net (loss) income	(1,558)	3,013	(4,664)	5,304
Foreign currency translation adjustments, net of tax	(766)	(1,881)	(74)	(833)
Unrealized (loss) gains on available-for-sale securities, net of tax	(3)	88	67	369
Comprehensive (loss) income	$(2,327)	$1,220	$(4,671)	$4,840
Net (loss) income	$(1,558)	$3,013	$(4,664)	$5,304
Net (loss) income per share from:				
Basic	$(0.05)	$0.10	$(0.14)	$0.18
Diluted	$(0.05)	$0.09	$(0.14)	$0.16
Weighted average shares used to compute net (loss) income per share:				
Basic	33,219,487	30,210,322	32,420,105	30,100,162
Diluted	33,219,487	33,308,193	32,420,105	33,137,364

See accompanying notes to the unaudited condensed consolidated financial statements

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Penumbra, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(4,664)	$5,304
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,422	1,146
Amortization of premium on marketable investments	436	445
Stock-based compensation	8,605	6,537
Inventory write downs	440	824
Deferred taxes	—	(207)
Other	367	129
Changes in operating assets and liabilities:		
Accounts receivable	(4,551)	(5,058)
Inventories	(6,827)	(12,035)
Prepaid expenses and other current and non-current assets	2,903	(9,847)
Accounts payable	293	1,330
Accrued expenses and other non-current liabilities	4,420	3,250
Net cash provided by (used in) operating activities	2,844	(8,182)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of non-marketable investments	(5,074)	—
Purchase of marketable investments	(90,384)	(27,467)
Proceeds from sales of marketable investments	28,167	2,504
Proceeds from maturities of marketable investments	35,669	28,962
Purchases of property and equipment	(5,364)	(3,695)
Deposit payments for acquisition	(454)	—
Change in restricted cash	(1,714)	—
Net cash (used in) provided by investing activities	(39,154)	304
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net of issuance cost	106,265	—
Proceeds from exercises of stock options	2,625	1,493
Proceeds from issuance of stock under employee stock purchase plan	2,914	3,783
Payment of employee taxes related to vested restricted stock	(9,190)	(1,846)
Net cash provided by financing activities	102,614	3,430
Effect of foreign exchange rate changes on cash and cash equivalents	(2,964)	(1,185)
Net Increase (Decrease) in Cash and Cash Equivalents	63,340	(5,633)
CASH AND CASH EQUIVALENTS—Beginning of period	13,236	19,547
CASH AND CASH EQUIVALENTS—End of period	$76,576	$13,914
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Purchase of property and equipment funded through accounts payable and accrued liabilities	$411	$560

See accompanying notes to the unaudited condensed consolidated financial statements

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Penumbra, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Organization and Description of Business

Penumbra, Inc. (the "Company") is a global healthcare company focused on interventional therapies. The Company designs, develops, manufactures and markets innovative devices and has a broad portfolio of products that addresses challenging medical conditions and significant clinical needs across two major markets, neuro and peripheral vascular. The conditions that the Company's products address include, among others, ischemic stroke, hemorrhagic stroke and various peripheral vascular conditions that can be treated through thrombectomy and embolization procedures.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying condensed consolidated balance sheet as of June 30, 2017, the condensed consolidated statements of operations and comprehensive (loss) income for the three and six months ended June 30, 2017 and 2016, and the condensed consolidated statements of cash flows for the six months ended June 30, 2017 and 2016 are unaudited. The unaudited condensed consolidated financial statements included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and the applicable rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial information. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The condensed consolidated balance sheet as of December 31, 2016 was derived from the audited financial statements as of that date.

The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to state fairly the Company's financial position as of June 30, 2017, the results of its operations for the three and six months ended June 30, 2017 and 2016, and the cash flows for the six months ended June 30, 2017 and 2016. The results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or for any other future annual or interim period. Certain changes in presentation were made in the condensed consolidated financial statements for the three and six months ended June 30, 2016, to conform to the presentation for the three and six months ended June 30, 2017.

The Company elected to early adopt Accounting Standards Update ("ASU") 2016-09 in the fourth quarter of 2016 which requires the Company to reflect any adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The impact of adoption was the creation of deferred tax assets ("DTAs") in the balance sheet and recognition of excess tax benefits in our provision for (benefit from) income taxes rather than paid-in capital for all periods in fiscal year 2016. The Company's adoption of ASU 2016-09 resulted in the recognition of excess tax benefits in the Company's benefit from income taxes rather than paid-in capital of $2.9 million and $4.4 million for the three and six months ended June 30, 2016, respectively. In addition, the Company elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively to all periods presented.

Adoption of the new standard resulted in adjustments to our 2016 unaudited selected financial data previously reported in our Quarterly Report on Form 10-Q as follows:

	June 30, 2016	
(In thousands)	As Reported	As Adjusted
Condensed Consolidated Balance Sheet Data:		
Prepaid expenses and other current assets	$17,406	$17,371
Total current assets	$260,252	$260,217
Total assets	$283,979	$283,944
Additional paid-in-capital	$266,650	$262,276
Accumulated deficit	$(16,510)	$(12,171)
Total stockholders' equity	$247,591	$247,556
Total liabilities and stockholders' equity	$283,979	$283,944

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Penumbra, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

(In thousands, except percentage and per share amounts)	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	As Reported	As Adjusted	As Reported	As Adjusted
Condensed Consolidated Statements of Operations Data:				
(Benefit from) provision for income taxes	$(568)	$ (3,396)	$773	$ (3,566)
Net income	$185	$ 3,013	$965	$ 5,304
Net income per share from:				
Basic	$0.01	$ 0.10	$0.03	$ 0.18
Diluted	$0.01	$ 0.09	$0.03	$ 0.16
Weighted average shares used to compute net income (loss) per share attributable to common stockholders for:				
Basic	30,210,322	30,210,322	30,100,162	30,100,162
Diluted	32,693,684	33,408,193	32,542,513	33,537,364

(In thousands)	Six Months Ended June 30, 2016	
	As Reported	As Adjusted
Condensed Consolidated Statement of Cash Flow Data:		
Net cash (used in) operating activities	$(12,555)	$(8,182)
Net cash provided by financing activities	$7,803	$3,430

The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2016 included in the Company's Annual Report on Form 10-K. During the six months ended June 30, 2017, the Company added an accounting policy for non-marketable equity investments. There have been no other changes to the Company's significant accounting policies during the six months ended June 30, 2017, as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity accounts; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to marketable investments, provisions for doubtful accounts, sales return reserve, warranty reserve, valuation of inventories, useful lives of property and equipment, income taxes, and contingencies, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other data. Actual results could differ from those estimates.

Non-Marketable Equity Investments

Entities in which the Company has at least a 20%, but not more than a 50%, interest are accounted for under the equity method unless it is determined that the Company has a controlling financial interest in the entity, in which case the entity would be consolidated. Non-marketable equity investments are classified as investments and included in other non-current assets on the condensed consolidated balance sheet. The Company's proportionate share of the operating results of its non-marketable equity method investments are recorded as profit or loss and included as a component of other expense, net, in the condensed consolidated statements of operations and comprehensive (loss) income. See Note 4 “Balance Sheet Components” for further details.

Segments

The Company determined its operating segment on the same basis that it uses to evaluate its performance internally. The Company has one business activity: the design, development, manufacturing and marketing of innovative medical devices, and operates as one operating segment. The Company’s chief operating decision-maker, its Chief Executive Officer, reviews its operating results for the purpose of allocating resources and evaluating financial performance. The Company determines revenue by geographic area, based on the destination to which it ships its products.

Recent Accounting Guidance

Recently Adopted Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which requires an entity to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. In January 2017, the Company adopted the standard on a prospective basis and the adoption did not have a material impact on its financial position.

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which outlines a comprehensive new revenue recognition model designed 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. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers—Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which further clarifies the implementation guidance on principal versus agent considerations contained in ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers—Identifying Performance Obligations and Licensing, which further clarifies the implementation guidance relating to identifying performance obligations and the licensing implementation guidance. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers—Narrow-Scope improvements and Practical Expedients, which further clarifies the implementation on narrow scope improvements and practical expedients. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606—Revenue from Contracts with Customers, which makes minor corrections or minor improvements to the Codification related to ASU No. 2014-09 that are not expected to have a significant effect on the Company's current accounting practice. These standards will be effective for the Company in the first quarter of 2018 pursuant to ASU No. 2015-14, Revenue from Contracts with Customers-Deferral of the Effective Date, issued by the FASB in August 2015. The Company intends to adopt the new standard on a modified retrospective basis on January 1, 2018. Under this method, the Company will record a cumulative-effect adjustment to the opening balance of retained earnings in the initial year of adoption. The timing of revenue recognition based on the guidance related to transfer of control may result in acceleration of revenue recognition for some contracts. The Company does not expect the impact of the new standard to be material, but it may result in expanded financial statement disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. As we continue our assessment through the remainder of 2017, our preliminary assessment is subject to change.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which amends the existing accounting standards for leases. Under the new guidance, a lessee will be required to recognize a lease liability and right-of-use asset for all leases with terms in excess of twelve months. The new guidance also modifies the classification criteria and accounting for sales-type and direct financing leases, and requires additional disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. Consistent with current guidance, a lessee's recognition, measurement, and presentation of expenses and cash flows arising from a lease will continue to depend primarily on its classification. The accounting standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and must be applied using a modified retrospective approach. Early adoption is permitted. While the Company is continuing to assess all potential impacts of the standard, it expects that most of its lease commitments will be subject to the updated standard and recognized as lease liabilities and right-of-use assets upon adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses. The standard changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The Company will recognize an allowance for credit losses on available-for-sale securities rather than deductions in amortized cost. The standard is effective for fiscal years and interim periods beginning after December 15, 2019. Early adoption is permitted for all periods beginning after December 15, 2018. The Company is currently evaluating the impact of adopting this standard.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash, a consensus of the FASB Emerging Issues Task Force. The standard requires companies to include amounts generally described as restricted cash and restricted cash equivalents in cash and cash equivalents when reconciling the total beginning and end of period amounts shown on the statement of cash flows. The standard is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The Company does not expect the adoption of ASU 2016-18 to have a material impact on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation - Scope of Modification Accounting. The standard provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This standard does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The standard is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. The guidance will be applied prospectively upon adoption. The Company does not expect the adoption of ASU 2017-09 to have a material impact on its consolidated financial statements, however the impact to share-based compensation expense will depend on the terms specified in any new changes to share-based payment awards subsequent to the adoption.

3. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance establishes a three-tiered hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as 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.

The categorization of a financial instrument within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The Company classifies its cash equivalents and marketable investments within Level 1 and Level 2, as it uses quoted market prices or alternative pricing sources and models utilizing market observable inputs.

The Company determined the fair value of its Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.

Financial instruments classified within Level 2 of the fair value hierarchy are valued based on other observable inputs, including broker or dealer quotations or alternative pricing sources. When quoted prices in active markets for identical assets or liabilities are not available, the Company relies on non-binding quotes from its investment managers, which are based on proprietary valuation models of independent pricing services. These models generally use inputs such as observable market data, quoted market prices for similar instruments, historical pricing trends of a security relative to its peers. To validate the fair value determination provided by its investment managers, the Company reviews the pricing movement in the context of overall market trends and trading information from its investment managers. In addition, the Company assesses the inputs and methods used in determining the fair value in order to determine the classification of securities in the fair value hierarchy.

The Company did not own any Level 3 financial assets or liabilities as of June 30, 2017 or December 31, 2016. During the six months ended June 30, 2017 and 2016, the Company did not record impairment charges related to its marketable investments, and the Company did not have any transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy.

The Company did not have any financial assets and liabilities measured at fair value on a non-recurring basis as of June 30, 2017 or December 31, 2016.

The following table sets forth the Company's financial assets and liabilities measured at fair value by level within the fair value hierarchy (in thousands):

	As of June 30, 2017		
	Level 1	Level 2	Total Fair Value
Financial Assets			
Cash equivalents:			
Commercial paper	$—	$19,188	$ 19,188
Money market funds	4,546	—	4,546
U.S. Treasury	4,997	—	4,997
U.S. states and municipalities	—	6,500	6,500
Marketable investments:			
Commercial paper	—	24,196	24,196
U.S. Treasury	8,997	—	8,997
U.S. agency and government sponsored securities	—	6,837	6,837
U.S. states and municipalities	—	8,256	8,256
Corporate bonds	—	93,782	93,782
Total	$18,540	$158,759	$ 177,299

	As of December 31, 2016		
	Level 1	Level 2	Total Fair Value
Financial Assets			
Cash equivalents:			
Money market funds	$873	$—	$ 873
Marketable investments:			
Commercial paper	—	4,238	4,238
U.S. Treasury	4,996	—	4,996
U.S. agency and government sponsored securities	—	8,794	8,794
U.S. states and municipalities	—	27,355	27,355
Corporate bonds	—	68,925	68,925
Non-U.S. government debt securities	—	1,209	1,209
Total	$5,869	$110,521	$ 116,390

4. Balance Sheet Components

Prepaid Expenses and Other Current Assets

The Company's prepaid expenses and other current assets as of June 30, 2017 and December 31, 2016 were comprised of the following (in thousands):

	June 30, 2017	December 31, 2016
Prepaid tax	$1,505	$ 4,656
Prepaid expenses	4,729	4,573
Other current assets	8,165	9,498
Prepaid expenses and other current assets	$14,399	$ 18,727

Penumbra, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

Marketable Investments

The Company’s marketable investments as of June 30, 2017 and December 31, 2016 were as follows (in thousands):

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	$24,198	$ 1	$ (3)	$24,196
U.S. Treasury	9,003			