Cardiovascular Systems Inc
Form 10-Q
May 08, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

Commission File No. 000-52082

CARDIOVASCULAR SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**No. 41-1698056**
(State or other jurisdiction of	**(IRS Employer**

incorporation or organization) **Identification No.)**

651 Campus Drive

St. Paul, Minnesota 55112-3495

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (651) 259-1600

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

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

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

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

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

The number of shares outstanding of the registrant s common stock as of April 30, 2012 was: Common Stock, $0.001 par value per share, 18,201,216 shares.

Table of Contents

Cardiovascular Systems, Inc.

Consolidated Financial Statements

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Cardiovascular Systems, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share and share amounts)

(Unaudited)

	March 31, 2012	June 30, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 22,455	$ 21,159
Accounts receivable, net	12,990	13,254
Inventories	7,824	5,818
Prepaid expenses and other current assets	980	797
Total current assets	44,249	41,028
Property and equipment, net	2,257	2,383
Patents, net	2,659	2,314
Debt conversion option and other assets	656	1,033
Total assets	$ 49,821	$ 46,758
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Current maturities of long-term debt	$ 3,478	$ 3,813
Accounts payable	5,072	5,181
Deferred grant incentive	784	647
Accrued expenses	6,804	5,545
Total current liabilities	16,138	15,186
Long-term liabilities		
Long-term debt, net of current maturities	14,063	8,331
Deferred grant incentive	199	1,497
Other liabilities	82	109
Total long-term liabilities	14,344	9,937
Total liabilities	30,482	25,123
Commitments and contingencies		
Common stock, $0.001 par value; authorized 100,000,000 common shares at March 31, 2012 and June 30, 2011; issued and outstanding 17,981,924 at March 31, 2012 and 16,987,068 at June 30, 2011, respectively	18	17
Additional paid in capital	184,464	174,157
Common stock warrants	9,489	9,909

Accumulated deficit	(174,632)	(162,448)
Total stockholders equity	19,339	21,635
Total liabilities and stockholders equity	$ 49,821	$ 46,758

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

Table of Contents

Cardiovascular Systems, Inc.

Consolidated Statements of Operations

(Dollars in thousands, except per share and share amounts)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Revenues	$ 21,205	$ 20,152	$ 59,583	$ 57,073
Cost of goods sold	5,132	3,949	14,038	12,063
Gross profit	16,073	16,203	45,545	45,010
Expenses				
Selling, general and administrative	16,809	16,415	47,892	46,597
Research and development	2,985	1,780	8,133	6,316
Total expenses	19,794	18,195	56,025	52,913
Loss from operations	(3,721)	(1,992)	(10,480)	(7,903)
Interest and other, net	(470)	(392)	(1,705)	(739)
Net loss	$ (4,191)	$ (2,384)	$ (12,185)	$ (8,642)
Net loss per common share:				
Basic and Diluted	$ (0.23)	$ (0.15)	$ (0.69)	$ (0.55)
Weighted average common shares used in computation:				
Basic and Diluted	17,977,819	16,146,667	17,746,558	15,778,287

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

Table of Contents

Cardiovascular Systems, Inc.

Consolidated Statements of Cash Flows

(Dollars in thousands)

(Unaudited)

	Nine Months Ended March 31,	
	2012	**2011**
Cash flows from operating activities		
Net loss	$ (12,185)	$ (8,642)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation and amortization of property and equipment	636	476
Amortization of patents	40	42
Provision for doubtful accounts	(30)	26
Debt conversion and valuation of conversion options, net	589	(422)
Stock-based compensation	3,919	5,221
Other		250
Changes in assets and liabilities		
Accounts receivable	294	(3,974)
Inventories	(2,006)	(546)
Prepaid expenses and other assets	314	395
Accounts payable	(109)	1,135
Accrued expenses and other liabilities	71	(1,111)
Net cash used in operations	(8,467)	(7,150)
Cash flows from investing activities		
Expenditures for property and equipment	(510)	(732)
Costs incurred in connection with patents	(385)	(522)
Net cash used in investing activities	(895)	(1,254)
Cash flows from financing activities		
Proceeds related to stock based compensation plans	669	365
Exercise of stock options and warrants	4,039	453
Proceeds from the issuance of long-term debt	7,885	4,000
Payments on long-term debt	(1,935)	(1,513)
Net cash provided by financing activities	10,658	3,305
Net change in cash and cash equivalents	1,296	(5,099)
Cash and cash equivalents		
Beginning of period	21,159	23,717
End of period	$ 22,455	$ 18,618

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

5

Table of Contents

CARDIOVASCULAR SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(For the nine months ended March 31, 2012 and 2011)

(dollars in thousands, except per share and share amounts)

(unaudited)

1. Business Overview

Company Description

Cardiovascular Systems, Inc. was incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its reverse merger with Cardiovascular Systems, Inc., a Minnesota corporation incorporated in 1989 (CSI-MN), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the Merger Agreement). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly-owned subsidiary of Replidyne. At the effective time of the merger, Replidyne, Inc. changed its name to Cardiovascular Systems, Inc. (CSI) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation.

The Company develops, manufactures and markets devices for the treatment of vascular diseases. The Company s primary products, the Diamondback 360° PAD System, the Predator 360° PAD System, and the Stealth 360° PAD System, are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee and address many of the limitations associated with existing treatment alternatives. This includes calcified lesions, which are more difficult and expensive to treat and have higher rates of adverse events and restenosis. Prior to the merger, Replidyne was a biopharmaceutical company focused on discovering, developing, in-licensing and commercializing innovative anti-infective products.

2. Summary of Significant Accounting Policies

Interim Financial Statements

The Company has prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial statements. The year-end consolidated balance sheet was derived from the Company s audited consolidated financial statements, but does not include all disclosures as required by GAAP. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to state fairly the Company s consolidated financial position, the results of its operations and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Form 10-K filed by the Company with the SEC on September 12, 2011. The nature of the Company s business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

Fair Value of Financial Instruments

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

The fair value guidance classifies inputs into the following hierarchy:

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

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

Level 3 Inputs unobservable inputs

Table of Contents

The following table sets forth the fair value of the Company s financial instruments that were measured on a recurring basis as of March 31, 2012. Assets are measured on a recurring basis if they are remeasured at least annually:

	Level 3 Conversion Option
Balance at June 30, 2011	$ 925
Issuance of $1,500 in convertible notes	295
Change in conversion option valuation	(454)
Conversion of $500 convertible note	(182)
Balance at March 31, 2012	$ 584

The fair value of the conversion option is related to the loan and security agreement with Partners for Growth (described in Note 4) and has been included in debt conversion option and other assets on the balance sheet. The Monte Carlo option pricing model used to determine the value of the conversion option included various inputs including historical volatility, stock price simulations, and assessed behavior of the Company and Partners for Growth based on those simulations. Based upon these inputs, the Company considers the conversion option to be a Level 3 investment.

As of March 31, 2012, the Company believes that the carrying amounts of its other financial instruments, including accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the short-term maturities of these instruments. The carrying amount of long-term debt approximates fair value based on interest rates currently available for debt with similar terms and maturities.

Use of Estimates

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

Stock-Based Compensation

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

Revenue Recognition

The Company sells the majority of its products via direct shipment to hospitals or clinics. The Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and collectability is reasonably assured. These criteria are met at the time of delivery when the risk of loss and title passes to the customer. The Company records estimated sales returns, discounts and rebates as a reduction of net sales in the same period revenue is recognized.

Recent Accounting Pronouncements

In May 2011, the FASB issued guidance to amend the accounting and disclosure requirements on fair value measurements. The new guidance limits the highest-and-best-use measure to nonfinancial assets, permits certain financial assets and liabilities with offsetting positions in market or counterparty credit risks to be measured at a net basis, and provides guidance on the applicability of premiums and discounts. Additionally, the new guidance expands the disclosures on Level 3 inputs by requiring quantitative disclosure of the unobservable inputs and assumptions, as well as description of the valuation processes and the sensitivity of the fair value to changes in unobservable inputs. The new guidance became effective for the Company beginning January 1, 2012. Other than requiring additional disclosures, there was no material impact on our consolidated financial statements upon adoption.

In June 2011, the FASB issued guidance requiring that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The new guidance will be effective for the Company beginning July 1, 2012. Other than requiring additional disclosures, the Company does not anticipate material impacts on its consolidated financial statements upon adoption as the Company has no other comprehensive income.

Table of Contents

3. Selected Consolidated Financial Statement Information

Inventories

Inventories are stated at the lower of cost or market with cost determined on a first-in, first-out (FIFO) method of valuation.

At March 31, 2012 and June 30, 2011, respectively, inventories were comprised of the following:

	March 31, 2012	June 30, 2011
Inventories		
Raw materials	$ 3,906	$ 2,705
Work in process	571	640
Finished goods	3,347	2,473
	$ 7,824	$ 5,818

4. Debt

Loan and Security Agreement with Silicon Valley Bank

On March 29, 2010, the Company entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement was amended on December 27, 2011. The agreement, as amended, includes a $12,000 term loan and a $15,000 line of credit. The terms of each of these loans are as follows:

The $12,000 term loan has an initial interest rate of 8.0%, which can be reduced to 7.0% based on the achievement of positive EBITDA for the trailing six month period. The term loan has a 36 month maturity, with repayment terms that include interest only payments during the first six months, followed by 30 equal principal payments of $400 plus interest, and a final payment of $100 due at maturity. This term loan also includes an acceleration provision that requires the Company to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0% of the principal amount, upon prepayment or the occurrence and continuance of an event of default. The balance outstanding on the term loan at March 31, 2012 was $11,664. The unamortized discount associated with warrants issued to Silicon Valley Bank in connection with the loan and other fees paid to the lender will be amortized over the 36 month maturity period. This amendment is being accounted for as a debt modification.

The $15,000 line of credit expires March 31, 2014 and has a floating interest rate equal to Silicon Valley Bank s prime rate, plus 2.0%, with an interest rate floor of 6.0%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on (a) 80% of eligible domestic receivables, plus (b) the lesser of 40% of eligible inventory or 25% of eligible domestic receivables or $2,500, minus (c) to the extent in effect, certain loan reserves as defined in the agreement. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The line of credit is subject to non-use fees, annual fees, and cancellation fees. The agreement provides that upon the achievement of certain financial covenants, the amount reducing available borrowings will be zero, however, if certain financial covenants are not met, 75% of the outstanding principal balance of the $12,000 term loan reduces available borrowings under the line of credit. There was not an outstanding balance on the line of credit at March 31, 2012.

Borrowings from Silicon Valley Bank are secured by all of the Company s assets. The borrowings are subject to prepayment penalties and financial covenants, including maintaining certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. The Company was in compliance with all financial covenants as of March 31, 2012. The agreement also includes subjective acceleration clauses which permit Silicon Valley Bank to accelerate the due date under certain circumstances, including, but not limited to, material adverse effects on the Company s financial status or otherwise. Any non-compliance by the Company under the terms of debt arrangements could result in an event of default under the Silicon Valley Bank loan, which, if not cured, could result in the acceleration of this debt.

Table of Contents

Loan and Security Agreement with Partners for Growth

On April 14, 2010, the Company entered into a loan and security agreement with Partners for Growth III, L.P. (PFG). The agreement, as amended, provides that PFG will make loans to the Company up to $4,000. The agreement has a maturity date of April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank s prime rate, and such interest is payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by the Company at any time in whole or in part. On August 23, 2011, the loan and security agreement was amended to provide that PFG will make loans to the Company up to $5,000. All other terms of the original agreement remain the same. On December 27, 2011, the loan and security agreement, as amended, raises the total amount of indebtedness that the Company may accrue under the term loan portion of the amended and restated loan and security agreement with Silicon Valley Bank, as amended, from $10,000 to $12,000.

As of March 31, 2012, PFG has provided the Company the following three loans totaling $5,000 that are outstanding: (i) a $3,500 loan dated June 30, 2011 with a conversion price of $13.64, (ii) a $500 loan dated August 4, 2011, as amended and restated August 24, 2011, with a conversion price of $15.30, and (iii) a $1,000 loan dated August 24, 2011 with a conversion price of $13.42. At any time prior to the maturity date, PFG may at its option convert any of the outstanding loans into shares of the Company s common stock at the applicable conversion price, which in each case equaled the ten-day volume weighted average price per share of the Company s common stock prior to the issuance date of each note. The Company may also effect at any time a mandatory conversion of amounts, subject to certain terms, conditions and limitations provided in the agreement, including a requirement that the ten-day volume weighted average price of the Company s common stock prior to the date of conversion is at least 15% greater than the conversion price. The Company may reduce the conversion price to a price that represents a 15% discount to the ten-day volume weighted average price of its common stock to satisfy this condition and effect a mandatory conversion. During the nine months ended March 31, 2012, PFG, at its option, converted a $500 loan (at par) into 40,323 shares of the Company s common stock in accordance with the conversion terms set forth in the agreement. The Company has reflected a net expense of $636 for the nine months ended March 31, 2012 as a component of interest and other, net on the accompanying statement of operations, which represents the net effect of (i) the write-off of the conversion option on the converted loan, (ii) the write-off of the unamortized debt premium on the converted loan and (iii) the change in fair value of the conversion options on all outstanding loans. The balance outstanding under the loan and security agreement at March 31, 2012 was $5,627. The net unamortized premium associated with warrants issued to PFG in connection with the loan, a beneficial conversion feature, and other fees paid to the lender will be amortized over the remaining maturity period.

The loans are secured by certain of the Company s assets, and the agreement contains customary covenants limiting the Company s ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on its stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of its business. In addition, the PFG loan and security agreement contains financial covenants requiring the Company to maintain certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. The Company was in compliance with all financial covenants at March 31, 2012. If the Company does not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

As of March 31, 2012, debt maturities were as follows:

Three months ending June 30, 2012	$
2013	4,800
2014	5,050
2015	7,400
Total	$ 17,250
Less: Current Maturities	(3,478)
Long-Term Debt (excluding net unamortized premium)	$ 13,772
Add: Net Unamortized Premium	291
Long-term debt	$ 14,063

9

Table of Contents

5. Interest and Other, Net

Interest and other, net, includes the following:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Interest expense, net of premium amortization	$ (364)	$ (319)	$ (988)	$ (1,122)
Interest income	1	2	3	13
Change in fair value of conversion option	(70)	(61)	(453)	690
Net write-offs upon conversion (option and unamortized premium)			(182)	(275)
Other	(37)	(14)	(85)	(45)
Total	$ (470)	$ (392)	$ (1,705)	$ (739)

6. Stock Options and Restricted Stock Awards

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

The 2007 Plan originally allowed for the granting of up to 1,941,000 shares of common stock as approved by the board of directors in the form of nonqualified or incentive stock options, restricted stock awards, restricted stock unit awards, performance share awards, performance unit awards or stock appreciation rights to officers, directors, consultants and employees of the Company. The Plan was amended in February 2009 to increase the number of authorized shares to 2,509,969. Generally, options or shares granted under the 2007 Plan expire ten years from the date of grant and vest over three years. The amended 2007 Plan includes a renewal provision whereby the number of shares shall automatically be increased on the first day of each fiscal year ending on July 1, 2017, by the lesser of (i) 970,500 shares, (ii) 5% of the outstanding common shares on such date, or (iii) a lesser amount determined by the board of directors. On July 1, 2011, the number of shares available for grant was increased by 849,353 under the 2007 Plan renewal provision.

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

All options are fully vested. Vested options must be exercised at or within 90 days of termination to avoid forfeiture. The Company determined the fair value of options using the Black-Scholes option pricing model. The estimated fair value of options, including the effect of estimated forfeitures, was recognized as expense on a straight-line basis over the options vesting periods.

Stock option activity for the nine months ended March 31, 2012 is as follows:

	Number of Options(a)	Weighted Average Exercise Price
Options outstanding at June 30, 2011	3,070,999	$ 10.54
Options exercised	(255,202)	$ 9.39
Options forfeited or expired	(387,987)	$ 13.11

Options outstanding at March 31, 2012	2,427,810	$ 10.25

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

Table of Contents

The fair value of each restricted stock award is equal to the fair market value of the Company s common stock at the date of grant. Vesting of restricted stock awards ranges from one to three years. The estimated fair value of restricted stock awards, including the effect of estimated forfeitures, is recognized on a straight-line basis over the restricted stock s vesting period. Restricted stock award activity for the nine months ended March 31, 2012 is as follows:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards outstanding at June 30, 2011	1,198,207	$ 6.39
Restricted stock awards granted	579,878	$ 12.13
Restricted stock awards forfeited	(196,830)	$ 7.54
Restricted stock awards vested	(438,640)	$ 13.49
Restricted stock awards outstanding at March 31, 2012	1,142,615	$ 8.94

7. Texas Production Facility

Effective on September 9, 2009, the Company entered into an agreement with the Pearland Economic Development Corporation (the PEDC) for the construction and lease of an approximately 46,000 square foot production facility located in Pearland, Texas. The facility primarily serves as an additional manufacturing location for the Company.

The lease agreement provides that the PEDC will lease the facility and the land immediately surrounding the facility to the Company for an initial term of ten years, which began April 1, 2010. Monthly fixed rent payments are $35 for each of the first five years of the initial term and $38 for each of the last five years of the initial term. The Company is also responsible for paying the taxes and operating expenses related to the facility. The lease has been classified as an operating lease for financial statement purposes. Upon an event of default under the agreement, the Company will be liable for the difference between the balance of the rent owed for the remainder of the term and the fair market rental value of the leased premises for such period.

The Company has the option to renew the lease for up to two additional periods of five years each. If the Company elects to exercise one or both of these options, the rent for such extended terms will be set at the prevailing market rental rates at such times, as determined in the agreement. After the commencement date and until shortly before the tenth anniversary of the commencement date, the Company will have the option to purchase all, but not less than all, of the leased premises at fair market value, as determined in the agreement. Further, within six years of the commencement date and subject to certain conditions, the Company has options to cause the PEDC to make two additions or expansions to the facility of a minimum of 34,000 and 45,000 square feet each.

The Company and the PEDC previously entered into a Corporate Job Creation Agreement dated June 17, 2009 (the Job Creation Agreement). The Job Creation Agreement provided the Company with $2,975 in net cash incentive funds. The Company believes it will be able to comply with the conditions specified in the Job Creation Agreement. The PEDC will provide the Company with an additional $1,700 of net cash incentive funds in the following amounts and upon achievement of the following milestones:

$1,020, upon the hiring of the 75th full-time employee at the facility; and

$680, upon the hiring of the 125th full-time employee at the facility.

In order to retain all of the cash incentives, beginning one year and 90 days after the commencement date, the Company must not have a planned reduction in the number of employees, resulting in fewer than 25 full-time employees at the facility for more than 120 consecutive days. Failure to meet this requirement will result in an obligation to make reimbursement payments to the PEDC as outlined in the agreement. The Company will not have any reimbursement requirements after 60 months from the effective date of the agreement. As of March 31, 2012, the Company was in compliance with all minimum requirements under the agreement.

The Job Creation Agreement also provides the Company with a net $1,275 award, of which $510 will be funded by a grant from the State of Texas for which the Company has applied through the Texas Enterprise Fund program. As of March 31, 2012, $340 of the grant from the State of Texas has been received and the remaining $170 will be provided if the Company hires a 55th full-time employee at the facility. The PEDC has committed, by resolution, to guarantee the full award and will make payment to the Company for the remaining $765. As of March 31, 2012, $510 of that remaining $765 has been received. The grant from the State of Texas is subject to reimbursement if the Company fails to meet certain job creation targets through 2014 and maintain these positions through 2020.

Table of Contents

The Company has presented the net cash incentive funds as a current and long-term liability on the balance sheet. The liabilities will be reduced over a 60 month period and recorded as an offset to expenditures incurred using a systematic methodology that is intended to reduce the majority of the liabilities in the first 24 months of the agreement. As of March 31, 2012, $3,097 in cumulative expenses has reduced the deferred grant incentive liabilities, resulting in a remaining current liability of $784 and long-term liability of $199.

8. Commitment and Contingencies

Michael Kallok Claim

On July 18, 2011, the Company received a demand letter from legal counsel for Michael Kallok, a former officer, director and consultant to the Company, claiming that Mr. Kallok is entitled to 42,594 shares of the Company s common stock or, alternatively, the value of those shares as of July 15, 2011, which was $611. Mr. Kallok asserts that the Company improperly deemed such shares forfeited under a restricted stock agreement with Mr. Kallok. This matter is proceeding to arbitration.

The Company is defending this claim vigorously, and believes that an adverse outcome of this dispute would not have a materially adverse effect on the Company s business, operations, cash flows or financial condition. The Company has not recognized any expense related to the settlement of this matter as it believes an adverse outcome of this action is not probable.

9. Earnings Per Share

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Numerator				
Net loss	$ (4,191)	$ (2,384)	$ (12,185)	$ (8,642)
Denominator				
Weighted average common shares basic	17,977,819	16,146,667	17,746,558	15,778,287
Effect of dilutive stock options and warrants (a)(b)(c)				
Weighted average common shares outstanding diluted	17,977,819	16,146,667	17,746,558	15,778,287
Net loss per common share basic and diluted	$ (0.23)	$ (0.15)	$ (0.69)	$ (0.55)

(a) At March 31, 2012 and 2011, 2,433,488 and 3,176,497 warrants, respectively, were outstanding. The effect of the shares that would be issued upon exercise of these warrants has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

(b) At March 31, 2012 and 2011, 2,427,810 and 3,196,924 stock options, respectively, were outstanding. The effect of the shares that would be issued upon exercise of these options has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

(c) At March 31, 2012 and 2011, 363,794 and 402,641 additional shares of common stock are issuable upon the conversion of outstanding convertible debt agreements. The effect of the shares that would be issued upon conversion of these debt agreements has been excluded from the calculation of diluted loss per share because those shares are anti-dilutive.

Table of Contents

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 1 of Part I. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report, including information with respect to our plans and strategy for our business and expected financial results, includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors discussed in our Form 10-K for the year ended June 30, 2011 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

OVERVIEW

We are a medical device company focused on developing and commercializing interventional treatment systems for vascular disease. Our primary products, the Diamondback 360° PAD System (the Diamondback 360°), the Diamondback Predator 360° PAD System (the Predator 360°), and the Stealth 360° PAD System (the Stealth 360°) are catheter-based platforms capable of treating a broad range of plaque types in leg arteries both above and below the knee and address many of the limitations associated with existing treatment alternatives. This includes calcified lesions, which are more difficult and expensive to treat and have higher rates of adverse events and restenosis. The Stealth 360° contains additional ease of use features while maintaining a mechanism of action identical to that of the Diamondback 360° and Predator 360°. We also are pursuing approval of our products for coronary use. We refer to the Diamondback 360°, the Predator 360°, and the Stealth 360° collectively in this report as the PAD Systems.

We were incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its business combination with Cardiovascular Systems, Inc., a Minnesota corporation (CSI-MN), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the Merger Agreement). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly-owned subsidiary of Replidyne. Replidyne changed its name to Cardiovascular Systems, Inc. (CSI) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation. These transactions are referred to herein as the merger. Replidyne was a biopharmaceutical company focused on discovering, developing, in-licensing and commercializing anti-infective products.

At the closing of the merger, Replidyne s net assets, as calculated pursuant to the terms of the Merger Agreement, were approximately $36.6 million as adjusted. As of immediately following the effective time of the merger, former CSI stockholders owned approximately 80.2% of the outstanding common stock of the combined company, and Replidyne stockholders owned approximately 19.8% of the outstanding common stock of the combined company.

CSI was incorporated in Minnesota in 1989. From 1989 to 1997, we engaged in research and development on several different product concepts that were later abandoned. Since 1997, we have devoted substantially all of our resources to the development of the PAD Systems.

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

In August 2007, the FDA granted us 510(k) clearance for the use of the Diamondback 360° as a therapy in patients with PAD. We commenced commercial introduction of the Diamondback 360° in the United States in September 2007. We were granted 510(k) clearance of the Predator 360° in March 2009 and Stealth 360° in March 2011. We market the PAD Systems in the United States through a direct sales force and expend significant capital on our sales and marketing efforts to expand our customer base and utilization per customer. We assemble at our facilities the saline infusion pump used with our Stealth 360° product and the single-use catheter used in the PAD Systems with components purchased from third-party suppliers, as well as with components manufactured in-house. The control unit and guidewires are purchased from third-party suppliers.

As of March 31, 2012, we had an accumulated deficit of $174.6 million. We expect our losses to continue but generally decline as revenue grows from continued commercialization activities, development of additional product enhancements, accumulation of clinical data on our products, and further regulatory submissions. To date, we have financed our operations primarily from the issuance of common and preferred stock, convertible promissory notes, and debt.

13

Table of Contents

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

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

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

RESULTS OF OPERATIONS

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

	Three Months Ended March 31,			Nine Months Ended March 31,		
($ in thousands)	**2012**	**2011**	**Percent Change**	**2012**	**2011**	**Percent Change**
Revenues	$ 21,205	$ 20,152	5.2%	$ 59,583	$ 57,073	4.4%
Cost of goods sold	5,132	3,949	30.0	14,038	12,063	16.4
Gross profit	16,073	16,203	0.8	45,545	45,010	1.2
Expenses:						
Selling, general and administrative	16,809	16,415	2.4	47,892	46,597	2.8
Research and development	2,985	1,780	67.7	8,133	6,316	28.8
Total expenses	19,794	18,195	8.8	56,025	52,913	5.9
Loss from operations	(3,721)	(1,992)	86.8	(10,480)	(7,903)	32.6
Interest and other, net	(470)	(392)	19.9	(1,705)	(739)	130.7
Net loss	$ (4,191)	(2,384)	75.8	(12,185)	(8,642)	41.0

Comparison of Three Months Ended March 31, 2012 with Three Months Ended March 31, 2011

Revenues. Revenues increased by $1.1 million, or 5.2%, from $20.2 million for the three months ended March 31, 2011 to $21.2 million for the three months ended March 31, 2012. This increase was attributable to a $1.2 million, or 6.6%, increase in revenues generated from the sale of PAD Systems, primarily from increased average selling prices as a result of the introduction of the Stealth 360°. This increase was partially offset by the decrease in supplemental product and other revenue of $109,000, or 4.3%, primarily from the termination of a distribution agreement. Supplemental product and other revenues include our Viper product line, wires, freight & handling and distribution partner products.

Currently, all of our revenues are in the United States; however, we may potentially sell internationally in the future. We expect our revenue to increase as we continue to increase the number of physicians using the device, increase the usage per physician, introduce new and improved

products, and generate clinical data.

Cost of Goods Sold. Cost of goods sold increased by $1.2 million, or 30.0%, from $3.9 million for the three months ended March 31, 2011 to $5.1 million for the three months ended March 31, 2012. Cost of goods sold represents the cost of materials, labor and overhead for single-use catheters, guidewires, control units, and other ancillary products. The increase was due to a higher mix of Stealth 360° sales, which currently carry higher unit costs due to limited initial component purchasing volumes. Also, the addition of our second manufacturing facility in Texas for future production capacity has temporarily increased production costs. We expect that

Table of Contents

the gross margin will stay fairly consistent through the end of this fiscal year, and then gradually improve as Stealth 360° production increases and the Texas facility becomes more fully utilized. Quarterly fluctuations could occur based on timing of new product introductions, sales mix, pricing changes, or other unanticipated circumstances.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses increased by $394,000, or 2.4%, from $16.4 million for the three months ended March 31, 2011 to $16.8 million for the three months ended March 31, 2012. The primary reason for the increase was due to additional expenses relating to the building of our sales and marketing organization and medical education training programs, partially offset by decreased stock-based compensation. Selling, general and administrative expenses for the three months ended March 31, 2012 and 2011 includes $1.0 million and $1.4 million, respectively, for stock-based compensation. We expect our selling, general and administrative expenses to increase in the future due primarily to the costs associated with expanding our sales and marketing organization to further commercialize our products, and preparation for the coronary market. Fluctuations from these expectations could occur based on the timing of expenditures.

Research and Development Expenses. Research and development expenses increased by $1.2 million, or 67.7%, from $1.8 million for the three months ended March 31, 2011 to $3.0 million for the three months ended March 31, 2012. Research and development expenses relate to specific projects to improve our products or expand into new markets, such as the development of new versions of the PAD Systems, shaft designs, crown designs, and PAD and coronary clinical trials. The increase was related to advancing the Orbit II clinical trial. Research and development expenses were favorably affected during the three months ended March 31, 2011 by a $201,000 non-recurring benefit relating to the forfeiture of stock awards. As we continue to expand our product portfolio within the market for the treatment of peripheral arteries and leverage our core technology into the coronary market, we generally expect to incur increased quarterly research and development expenses throughout the remainder of fiscal year 2012. Fluctuations from these expectations could occur based on the number of projects and studies and the timing of expenditures.

Interest and Other, net. Interest and other expense increased by $78,000, or 19.9%, from expense of $392,000 for the three months ended March 31, 2011 to expense of $470,000 for the three months ended March 31, 2012. This increase in interest and other was primarily due to an increase in interest expense as a result of an increase in the amount of outstanding debt.

Comparison of Nine Months Ended March 31, 2012 with Nine Months Ended March 31, 2011

Revenues. Revenues increased by $2.5 million, or 4.4%, from $57.1 million for the nine months ended March 31, 2011 to $59.6 million for the nine months ended March 31, 2012. This increase was attributable to a $2.7 million, or 5.5%, increase in revenue generated from the sale of PAD Systems, primarily from increased average selling prices as a result of the introduction of the Stealth 360°. Supplemental product and other revenues slightly declined by $233,000, or 3.3%, from $7.0 million for the nine months ended March 31, 2011, to $6.7 million for the nine months ended March 31, 2012, primarily from the termination of a distribution agreement. Supplemen