
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 March 31, 2015

OR

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

Commission File Number 001-33624

Amedica Corporation

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of
incorporation or organization)

84-1375299

(IRS Employer
Identification No.)

1885 West 2100 South, Salt Lake City, UT

(Address of principal executive offices)

84119

(Zip Code)

(801) 839-3500

(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, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

55,371,597 shares of common stock, \$0.01 par value, were outstanding at May 6, 2015

Amedica Corporation
Table of Contents

[Part I. Financial Information](#)

| | |
|---|--------------------|
| Item 1. Financial Statements | 3 |
| Condensed Consolidated Balance Sheets (unaudited) | 3 |
| Condensed Consolidated Statements of Operations and Comprehensive Loss (unaudited) | 4 |
| Condensed Consolidated Statements of Cash Flows (unaudited) | 5 |
| Notes to Condensed Consolidated Financial Statements (unaudited) | 6 |
| Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations | 15 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 26 |
| Item 4. Controls and Procedures | 26 |

[Part II. Other Information](#)

| | |
|---|--------------------|
| Item 1. Legal Proceedings | 26 |
| Item 1A. Risk Factors | 26 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 27 |
| Item 3. Defaults Upon Senior Securities | 27 |
| Item 4. Mine Safety Disclosures | 27 |
| Item 5. Other Information | 27 |
| Item 6. Exhibits | 27 |

| | |
|----------------------------|--------------------|
| Signatures | 28 |
|----------------------------|--------------------|

Amedica Corporation
Condensed Consolidated Balance Sheets - Unaudited
(in thousands, except share and per share data)

| | <u>March 31, 2015</u> | <u>December 31, 2014</u> |
|--|-----------------------|--------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 14,882 | \$ 18,247 |
| Trade accounts receivable, net of allowance of \$60 and \$54, respectively | 2,568 | 2,513 |
| Prepaid expenses and other current assets | 1,464 | 1,247 |
| Inventories, net | 11,197 | 11,675 |
| Total current assets | <u>30,111</u> | <u>33,682</u> |
| Property and equipment, net | 3,286 | 3,515 |
| Intangible assets, net | 4,063 | 4,188 |
| Goodwill | 6,163 | 6,163 |
| Other long-term assets | 35 | 35 |
| Total assets | <u>\$ 43,658</u> | <u>\$ 47,583</u> |
| Liabilities and stockholders' equity (deficit) | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,217 | \$ 778 |
| Accrued liabilities | 3,117 | 3,146 |
| Current portion of long-term debt | 19,157 | 19,070 |
| Total current liabilities | <u>23,491</u> | <u>22,994</u> |
| Deferred rent | 497 | 517 |
| Long-term debt | 3,110 | 3,061 |
| Other long-term liabilities | 134 | 134 |
| Derivative liabilities | 13,245 | 13,970 |
| Commitments and contingencies | | |
| Stockholders' equity (deficit): | | |
| Common stock, \$0.01 par value; 250,000,000 shares authorized; 29,092,095 and 26,353,666 shares issued at March 31, 2015 and December 31, 2014, respectively | 291 | 264 |
| Additional paid-in capital | 180,896 | 179,148 |
| Treasury Stock | (120) | — |
| Accumulated deficit | (177,886) | (172,505) |
| Total stockholders' equity | <u>3,181</u> | <u>6,907</u> |
| Total liabilities and stockholders' equity | <u>\$ 43,658</u> | <u>\$ 47,583</u> |

See accompanying notes.

Amedica Corporation
Condensed Consolidated Statements of Operations and Comprehensive Loss - Unaudited
(in thousands, except share and per share data)

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2015 | 2014 |
| Product revenue | \$ 4,743 | \$ 5,780 |
| Costs of revenue | 1,522 | 1,649 |
| Gross profit | 3,221 | 4,131 |
| Operating expenses: | | |
| Research and development | 1,843 | 591 |
| General and administrative | 2,027 | 3,075 |
| Sales and marketing | 3,357 | 4,521 |
| Total operating expenses | 7,227 | 8,187 |
| Loss from operations | (4,006) | (4,056) |
| Other income (expense): | | |
| Interest income | — | 3 |
| Interest expense | (1,100) | (530) |
| Loss on extinguishment of debt | (79) | — |
| Change in fair value of derivative liabilities | (177) | (114) |
| Loss on extinguishment of derivative liabilities | (16) | — |
| Other expense | (3) | (16) |
| Total other income (expense) | (1,375) | (657) |
| Net loss before income taxes | (5,381) | (4,713) |
| Provision for income taxes | — | — |
| Net Comprehensive Loss | (5,381) | (4,713) |
| Net loss per share attributable to common stockholders: | | |
| Basic and diluted | \$ (0.20) | \$ (0.79) |
| Weighted average common shares outstanding: | | |
| Basic and diluted | 26,929,447 | 5,967,400 |

See accompanying notes.

Amedica Corporation
Condensed Consolidated Statements of Cash Flows - Unaudited
(in thousands)

| | Three Months Ended March 31, | |
|---|-------------------------------------|------------------|
| | 2015 | 2014 |
| Cash flows from operating activities | | |
| Net loss | \$ (5,381) | \$ (4,713) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation expense | 428 | 433 |
| Amortization of intangible assets | 125 | 125 |
| Amortization of lease incentive for tenant improvements | 5 | 2 |
| Non cash interest expense | 551 | 209 |
| Loss on extinguishment of debt | 79 | — |
| Stock based compensation | 592 | 1,404 |
| Change in fair value of derivative liabilities | 177 | 114 |
| (Gain) Loss on extinguishment of derivative liabilities | 16 | — |
| Loss on disposal of equipment | 3 | 22 |
| Provision for inventory reserve | 326 | 415 |
| Bad debt expense (recovery) | (20) | (17) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (35) | 268 |
| Prepaid expenses and other current assets | (330) | 2,610 |
| Inventories | 293 | (1,958) |
| Accounts payable and accrued liabilities | 200 | (915) |
| Net cash used in operating activities | <u>(2,971)</u> | <u>(2,001)</u> |
| Cash flows from investing activities | | |
| Purchase of property and equipment | (277) | (548) |
| Proceeds from sale of property and equipment | 3 | — |
| Decrease in restricted cash | — | (42) |
| Net cash used in investing activities | <u>(274)</u> | <u>(590)</u> |
| Cash flows from financing activities | | |
| Proceeds from issuance of common stock, net of issuance costs | — | 15,369 |
| Payments on long-term debt | — | (1,800) |
| Purchase of treasury stock | (120) | — |
| Net cash provided by (used in) financing activities | <u>(120)</u> | <u>13,569</u> |
| Net increase (decrease) in cash and cash equivalents | (3,365) | 10,978 |
| Cash and cash equivalents at beginning of period | 18,247 | 2,279 |
| Cash and cash equivalents at end of period | <u>\$ 14,882</u> | <u>\$ 13,257</u> |
| Noncash investing and financing activities | | |
| Preferred stock converted into common stock | \$ — | \$ 161,456 |
| Reclassification of warrant liability | \$ — | \$ 5 |
| Debt converted to common stock | \$ 202 | \$ — |
| Common stock issued with extinguishment of derivative liabilities | \$ 739 | \$ — |
| Supplemental cash flow information | | |
| Cash paid for interest | \$ 548 | \$ 238 |

See accompanying notes.

AMEDICA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization

Amedica Corporation (“Amedica” or “the Company”) was incorporated in the state of Delaware on December 10, 1996. Amedica is a commercial-stage biomaterials company focused on using its silicon nitride technology platform to develop, manufacture, and commercialize a broad range of medical devices. The Company believes it is the first and only manufacturer to use silicon nitride in medical applications. The Company acquired US Spine, Inc. (“US Spine”), a Delaware spinal products corporation with operations in Florida, on September 20, 2010. The Company’s products are sold primarily in the United States.

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated audited financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 24, 2015. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. The Company’s significant accounting policies are set forth in Note 1 to the consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2014.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (“U.S. GAAP”) 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 revenue and expenses during the period. Actual results could differ from those estimates. Some of the more significant estimates relate to inventory, allowance for accounts receivable, stock-based compensation, long-lived and intangible assets and derivative liabilities.

Liquidity and Capital Resources

For the three months ended March 31, 2015 and 2014, the Company incurred a net loss of \$5.4 million and \$4.7 million, respectively, and used cash in operations of \$3.0 million and \$2.0 million, respectively. The Company had an accumulated deficit of \$177.9 million and \$172.5 million at March 31, 2015 and December 31, 2014, respectively. To date, the Company’s operations have been principally financed from proceeds from the issuance of preferred and common stock, convertible debt and bank debt and, to a lesser extent, cash generated from product sales. It is anticipated that the Company will continue to generate operating losses and use cash in operations through 2015.

As discussed further in Note 7, the Company has entered into a term loan with Hercules Technology Growth Capital, Inc. (“Hercules Technology”), as administrative and collateral agent for the lenders thereunder and as lender, and Hercules Technology III, LP, as lender (the “Hercules Term Loan”). The Hercules Term Loan has a liquidity covenant that requires the Company to maintain a cash balance of not less than \$9.0 million. At March 31, 2015, the Company’s cash balance was approximately \$14.9 million. The Company anticipates that it will need to obtain additional funding during the fourth quarter of 2015 to maintain compliance with the liquidity covenants related to the Hercules Term Loan through 2015. Furthermore, if the Company is unable to access additional funds prior to becoming non-compliant with the liquidity covenant, the entire remaining balance of the debt could become immediately due and payable at the option of the lender. Although the Company is seeking additional financing, additional funding may not be available to the Company on acceptable terms, or at all. Any additional equity financing, if available to the Company, may not be available on favorable terms and will most likely be dilutive to its current stockholders, and debt financing, if available, may involve more restrictive covenants. The Company’s ability to access capital when needed is not assured and, if not achieved on a timely basis, will materially harm its business, financial condition and results of operations. These uncertainties create substantial doubt about the Company’s ability to continue as a going concern. No adjustment has been made to our financial statements as a result of this uncertainty.

[Table of Contents](#)

Significant Accounting Policies

There have been no significant changes to the Company's significant accounting policies as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") updated the accounting guidance related to revenue from contracts with customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle is that a company should recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. The standard defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, and shall be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In August 2014, the FASB updated the accounting guidance related to disclosure of uncertainties about an entity's ability to continue as a going concern. The new standard provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. It requires management to perform interim and annual assessments of an entity's ability to continue as a going concern. The new standard is effective for annual periods ending after December 15, 2016, and interim periods thereafter. Early adoption is permitted. The impact on the Company's financial statements of adopting the new standard is currently being assessed by management.

In April 2015, the FASB updated the accounting guidance related to simplifying the presentation of debt issuance costs on the balance sheet. The new standard requires that debt issuance costs be presented as a direct deduction from the associated debt liability. It will be effective on January 1, 2016, and early adoption is permitted. The standard will be applied retrospectively to all prior periods presented. The Company expects that the new standard will impact the presentation of its consolidated balance sheet.

2. Basic and Diluted Net Loss per Common Share

Basic net loss per share is calculated by dividing the net loss by the weighted-average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share is calculated by dividing the net loss by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. Dilutive common stock equivalents are comprised of warrants for the purchase of common stock, convertible notes, stock options and unvested restricted stock units. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding because their effect would have been anti-dilutive due to the Company reporting a net loss. The Company had potentially dilutive securities representing approximately 43.3 million and 2.8 million shares of common stock at March 31, 2015 and 2014, respectively.

3. Inventories

The components of inventory were as follows (in thousands):

| | March 31, 2015 | December 31, 2014 |
|----------------|-----------------------|--------------------------|
| Raw materials | \$ 950 | \$ 839 |
| WIP | 301 | 486 |
| Finished Goods | 9,946 | 10,350 |
| | <u>\$ 11,197</u> | <u>\$ 11,675</u> |

Finished goods include consigned inventory of approximately \$3.1 million and \$3.0 million as of March 31, 2015 and December 31, 2014, respectively.

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

| | March 31, 2015 | December 31, 2014 |
|---|----------------|-------------------|
| Customer relationships | \$ 3,990 | \$ 3,990 |
| Developed technology | 4,685 | 4,685 |
| Other patents and patent applications | 562 | 562 |
| Trademarks | 350 | 350 |
| Total Intangible Assets | 9,587 | 9,587 |
| Less accumulated amortization | (5,524) | (5,399) |
| Total Intangible Assets net of amortization | \$ 4,063 | \$ 4,188 |

Based on the recorded intangibles at March 31, 2015, the estimated amortization expense is expected to be \$375,000 during the remainder of 2015 and approximately \$501,000 per year through 2019 and \$1.3 million thereafter.

5. Fair Value Measurements

Financial Instruments Measured and Recorded at Fair Value on a Recurring Basis

The Company measures and records certain financial instruments at fair value on a recurring basis. Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, under a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

- Level 1 - quoted market prices for identical assets or liabilities in active markets.
- Level 2 - observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3 - unobservable inputs reflecting management's assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

The Company classifies assets and liabilities measured at fair value in their entirety based on the lowest level of input that is significant to their fair value measurement. No financial assets were measured on a recurring basis at March 31, 2015 and December 31, 2014. The following tables set forth the financial liabilities measured at fair value on a recurring basis by level within the fair value hierarchy at March 31, 2015 and December 31, 2014:

| Description | Fair Value Measurements at March 31, 2015 | | | |
|------------------------------|---|---------|-----------|-----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Derivative liabilities | | | | |
| Common stock warrants | \$ — | \$ — | \$ 10,200 | \$ 10,200 |
| Conversion feature of notes | — | — | 3,045 | 3,045 |
| Total derivative liabilities | \$ — | \$ — | \$ 13,245 | \$ 13,245 |

| Description | Fair Value Measurements at December 31, 2014 | | | |
|------------------------------|--|---------|-----------|-----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Derivative liabilities | | | | |
| Common stock warrants | \$ — | \$ — | \$ 11,358 | \$ 11,358 |
| Conversion feature of notes | — | — | 2,612 | 2,612 |
| Total derivative liabilities | \$ — | \$ — | \$ 13,970 | \$ 13,970 |

The Company did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2015 and 2014. The following table presents a reconciliation of the derivative liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the three

[Table of Contents](#)

months ended March 31, 2015 and 2014:

| | Common Stock Warrants | Preferred Stock Warrants | Conversion Feature of Notes | Total Derivative Liability |
|---|--------------------------|-----------------------------|--------------------------------|-------------------------------|
| Balance at December 31, 2013 | \$ (199) | \$ (11) | \$ — | \$ (210) |
| Issuances of derivatives | — | — | — | \$ — |
| Reclassification from liability to equity | — | 5 | — | \$ 5 |
| Change in fair value | (120) | 6 | — | \$ (114) |
| Balance at March 31, 2014 | \$ (319) | \$ — | \$ — | \$ (319) |
| Balance at December 31, 2014 | \$ (11,358) | \$ — | \$ (2,612) | \$ (13,970) |
| Issuances of derivatives | — | — | — | \$ — |
| Decrease in liability due to debt conversions | — | — | 179 | \$ 179 |
| Decrease in liability due to warrants being exercised | 723 | — | — | \$ 723 |
| Change in fair value | 435 | — | (612) | \$ (177) |
| Balance at March 31, 2015 | \$ (10,200) | \$ — | \$ (3,045) | \$ (13,245) |

Common Stock Warrants

The Company has issued certain warrants to purchase shares of common stock, which are considered mark-to-market liabilities and are re-measured to fair value at each reporting period in accordance with accounting guidance.

The assumptions used in estimating the common stock warrant liability at March 31, 2015 and December 31, 2014 were as follows:

| | March 31, 2015 | December 31, 2014 |
|--|-------------------|-------------------|
| Fair value of common share | \$ 0.35 | \$ 0.80 |
| Weighted-average risk free interest rate | 1.25% | 1.53% |
| Weighted-average expected life | 4 years, 9 months | 4 years, 7 months |
| Expected dividend yield | —% | —% |
| Weighted average expected volatility | 119% | 116% |

Conversion Feature of Notes

The Company entered into convertible notes in 2014. The conversion features of the notes were evaluated and determined to be derivatives and are re-measured to fair value at each reporting period.

The assumptions used in estimating the conversion feature of the notes at March 31, 2015 and December 31, 2014 were as follows:

| | March 31, 2015 | December 31, 2014 |
|--|------------------|-------------------|
| Estimated fair value of common share | \$ 0.35 | \$ 0.80 |
| Weighted-average risk free interest rate | 0.26% | 0.67% |
| Weighted-average expected life | 1 year, 4 months | 1 year, 7 months |
| Expected dividend yield | —% | —% |
| Weighted average expected volatility | 126% | 32% |

Other Financial Instruments

The Company's recorded values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values based on their short-term nature. The recorded value of notes payable approximates the fair value as the interest rate approximates market interest rates.

6. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

| | March 31, 2015 | December 31, 2014 |
|------------------------------|-----------------|-------------------|
| Commissions | \$ 770 | \$ 846 |
| Payroll and related expenses | 923 | 1,001 |
| Royalties | 508 | 531 |
| Interest payable | 398 | 333 |
| Final loan payment fees | 353 | 233 |
| Deferred rent | 62 | 57 |
| Other | 103 | 145 |
| Total accrued liabilities | <u>\$ 3,117</u> | <u>\$ 3,146</u> |

7. Debt

On June 30, 2014, the Company entered into a Loan and Security Agreement with Hercules in connection with the Hercules Term Loan. The Hercules Term Loan provided the Company with a \$20 million term loan. On June 30, 2014, the Company also entered into a Securities Purchase Agreement with MG Partners II Ltd. (“Magna”) pursuant to which the Company sold to Magna an initial unsecured senior convertible note (“Initial Convertible Note”) with an original principal amount of \$2.9 million for a purchase price of \$2.5 million. Additionally, on August 11, 2014, the Company sold to Magna an additional unsecured senior convertible note (“Additional Convertible Note”) with an original principal amount of \$3.5 million for a purchase price of \$3.5 million. The Initial Convertible Note and the Additional Convertible Note are collectively referred to as the Magna Convertible Notes.

Hercules Term Loan

The Hercules Term Loan matures on January 1, 2018. The Hercules Term Loan included a \$200,000 closing fee, which was paid to Hercules Technology on the closing date of the loan. The closing fee has been recorded as a debt discount and is being amortized to interest expense over the life of the loan. The Hercules Term Loan also includes a non-refundable final payment fee of \$1.5 million. The final payment fee is being accrued and recorded to interest expense over the life of the loan. The Hercules Term Loan also has an early termination fee of \$1.2 million if the loan is paid prior to July 1, 2015.

The Hercules Term Loan bears interest at the rate of the greater of either (i) the prime rate plus 7.7%, and (ii) 10.95%. Interest accrues from the closing date of the loan and interest payments are due monthly. Principal payments are required commencing August 1, 2015 and are to be made in 30 equal installments of approximately \$700,000, with the remainder due at maturity.

The Hercules Term Loan contains certain covenants related to restrictions on payments to certain Company affiliates, financial reporting requirements and a minimum liquidity covenant that requires the Company to maintain cash and cash equivalents of not less than \$9 million. Although the Company was in compliance with the liquidity covenant at March 31, 2015, the Company anticipates that it will be non-compliant with the liquidity covenant during the fourth quarter of 2015 if additional financing is not obtained, and has therefore classified the entire obligation as a current liability.

Magna Convertible Notes

The Initial Convertible Note and the Additional Convertible Note mature on June 30, 2016 and August 11, 2016, respectively, (subject to extension by the holder) and accrue interest at an annual rate of 6.0%. At March 31, 2015, the outstanding principal amounts of the Initial Convertible Note and the Additional Convertible Note were \$798,000 and \$3.5 million, respectively.

The Magna Convertible Notes are convertible at any time after issuance, in whole or in part, at Magna’s option, into shares of common stock at a conversion price equal to the lesser of (i) \$3.75 per share or (ii) a price equal to 80% of the lowest daily volume weighted average price (“VWAP”) of our common stock during the five trading days prior to conversion.

During the three months ended March 31, 2015, Magna converted a total of \$202,000 of the principal amount of the Convertible Notes into 373,000 shares of common stock. The Company recorded a loss upon extinguishment of \$79,000 during the three months ended March 31, 2015.

[Table of Contents](#)

Outstanding long-term debt consisted of the following (in thousands):

| | March 31, 2015 | | | December 31, 2014 | | |
|-----------------------|-----------------------|----------------------|---------------------|-----------------------|----------------------|---------------------|
| | Outstanding Principal | Unamortized Discount | Net Carrying Amount | Outstanding Principal | Unamortized Discount | Net Carrying Amount |
| Hercules Term Loan | \$ 20,000 | \$ (843) | \$ 19,157 | \$ 20,000 | \$ (930) | \$ 19,070 |
| Convertible Note | 4,298 | (1,188) | 3,110 | 4,500 | (1,439) | 3,061 |
| Total debt | 24,298 | (2,031) | 22,267 | 24,500 | (2,369) | 22,131 |
| Less: Current portion | (20,000) | 843 | (19,157) | (20,000) | 930 | (19,070) |
| Long-term debt | \$ 4,298 | \$ (1,188) | \$ 3,110 | \$ 4,500 | \$ (1,439) | \$ 3,061 |

The following summarizes by year the future principal payments as of March 31, 2015 (in thousands):

| Years Ending December 31, | Hercules Term Loan | Magna Convertible Notes | Total |
|---------------------------------|--------------------|-------------------------|-----------|
| 2015 | \$ 2,949 | \$ — | \$ 2,949 |
| 2016 | 7,666 | 4,298 | 11,964 |
| 2017 | 8,567 | — | 8,567 |
| 2018 | 818 | — | 818 |
| 2019 | — | — | — |
| Total future principal payments | \$ 20,000 | \$ 4,298 | \$ 24,298 |

8. Equity

Secondary Offering

On November 26, 2014, the Company completed a secondary offering, in which the Company sold and issued 11,441,646 units. Each unit was issued at a price of \$1.14 and consisted of one share of common stock and one common stock warrant (“Secondary Offering Warrant”). The Company issued an additional 1,716,246 Secondary Offering Warrants pursuant to the underwriters’ over-allotment option.

The Secondary Offering Warrants were immediately exercisable after issuance into common shares at an exercise price of \$1.48 and terminate on November 26, 2019. The Secondary Offering Warrants contain a cashless exercise provision whereby the holders may exercise warrants by paying the exercise price in cash or, in lieu of payment of the exercise price in cash, at any time 120 days after issuance, by electing to receive a cash payment from the Company equal to the Black Scholes Value (as defined below) of the number of shares the holder elects to exercise (the “Black Scholes Payment”); provided that we have discretion as to whether to deliver the Black Scholes Payment or, subject to meeting certain conditions, to deliver a number of shares of our common stock determined according to the following formula (the “Cashless Exercise”):

$$\text{Total Shares} = (A \times B) / C$$

Where:

Total Shares is the number of shares of common stock to be issued upon a Cashless Exercise

A is the total number of shares with respect to which the warrant is then being exercised.

B is the Black Scholes Value (as defined below).

C is the closing bid price of our common stock as of two trading days prior to the time of such exercise.

As defined in the Secondary Offering Warrants, “Black Scholes Value” means the Black Scholes value of an option for one share of our common stock at the date of the applicable Black Scholes Payment or Cashless Exercise, which is calculated using the Black Scholes Option Pricing Model obtained from the “OV” function on Bloomberg utilizing (i) an underlying price per share equal to the closing bid price of the common stock as of trading day immediately preceding the date of issuance of the warrant, (ii) a risk-free interest rate corresponding to the U.S. Treasury rate for a period equal to the remaining term of the warrant as of the applicable Black Scholes Payment or Cashless Exercise, (iii) a strike price equal to the exercise price in effect at the time of the applicable Black Scholes Payment or Cashless Exercise, (iv) an expected volatility equal to 135% and (v) a remaining term of such option equal to five years (regardless of the actual remaining term of the warrant).

[Table of Contents](#)

The Secondary Offering Warrants are considered to be liabilities and are marked to market at each reporting period. During the three months ended March 31, 2015, 913,145 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 1,717,840 shares of common stock. Had the cashless exercise provision been exercised by all the holders of the remaining 12,244,747 Secondary Offering Warrants at March 31, 2015, the Company would have had to either pay \$9.7 million in cash or issue an additional 22,524,640 shares of common stock. The number of shares of common stock that would be required to satisfy the cashless exercise provision increases as the price of the Company's common stock decreases and decreases as the price of the Company's common stock increases.

Other Issuances

During the three months ended March 31, 2015, the Company issued 30,000 shares of common stock to a service provider as consideration for services to be rendered under a consulting agreement. Furthermore, 617,447 shares of common stock were issued upon the conversion of restricted stock units into common stock, of which 206,380 shares of common stock were withheld to satisfy the employees' tax withholding obligations associated with the conversion of the restricted stock units into common stock. The withheld shares are now included in treasury stock at a total value of \$120,000, which was based on the market price of the common stock on the date the shares were issued. Additionally, 242 shares of common stock were issued upon the exercise of warrants.

9. Stock-Based Compensation

Option and Equity Plans

In January 2015, the aggregate number of shares issuable under the 2012 Employee, Director and Consultant Equity Incentive Plan (the "2012 Plan") was increased by 586,181 to 3,586,181, in accordance with the 2012 plan.

The total number of shares available for grant under the 2012 Plan at March 31, 2015 was 115,082.

Stock Options

A summary of the Company's stock option activity for the three months ended March 31, 2015 was as follows:

| | Options | Weighted-Average Exercise Price |
|---|----------------|--|
| Outstanding at December 31, 2014 | 1,383,479 | \$ 5.13 |
| Granted | 1,485,759 | \$ 0.95 |
| Exercised | — | — |
| Forfeited | (889,822) | \$ 3.06 |
| Expired | (151,358) | \$ 3.06 |
| Outstanding at March 31, 2015 | 1,828,058 | \$ 2.92 |
| Exercisable at March 31, 2015 | 663,504 | \$ 6.21 |
| Vested and expected to vest at March 31, 2015 | 1,765,941 | \$ 2.98 |

The Company estimates the fair value of each stock option on the grant date using the Black-Scholes valuation model, which requires several estimates including an estimate of the fair value of the underlying common stock on grant date. The expected volatility was based on an average of the historical volatility of a peer group of similar companies. The expected term was calculated utilizing the simplified method. The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The following weighted average assumptions were used in the calculation to estimate the fair value of options granted to employees three months ended March 31, 2015 and 2014:

| | Three months ended March 31, | |
|---|-------------------------------------|-------------|
| | 2015 | 2014 |
| Weighted-average risk-free interest rate | 1.62% | 1.84% |
| Weighted-average expected life (in years) | 6.3 | 6.3 |
| Expected dividend yield | —% | —% |
| Weighted-average expected volatility | 46% | 48% |

[Table of Contents](#)

Restricted Stock Awards

Restricted stock awards (“RSA”) activity for the three months ended March 31, 2015 was as follows:

| | Number of Awards | Weighted-Average Grant Date Fair Value |
|-------------------------------|------------------|--|
| Unvested at December 31, 2014 | — | \$ — |
| Granted | 30,000 | \$ 0.75 |
| Vested | (30,000) | \$ 0.75 |
| Forfeited | — | \$ — |
| Unvested at March 31, 2015 | — | \$ — |

The total fair value of RSAs vested during the three months ended March 31, 2015 was \$23,000.

The Company recorded \$23,000 of stock-based compensation for RSUs during the three months ended March 31, 2015.

Stock-Based Awards Granted to Nonemployees

The Company from time to time grants options to purchase common stock or restricted stock to non-employees for services rendered and records expense ratably over the vesting period of each award. The Company estimates the fair value of the stock options using the Black-Scholes valuation model at each reporting date. No options were granted to non-employees during the three months ended March 31, 2015.

The following assumptions were used in the Black-Scholes valuation model related to non-employee stock options granted during the three months ended March 31, 2014:

| | |
|---|-------|
| Weighted-average risk-free interest rate | 2.78% |
| Weighted-average expected life (in years) | 10.0 |
| Expected dividend yield | —% |
| Weighted-average expected volatility | 45% |

Summary of Stock-Based Compensation Expense

Total stock-based compensation expense included in the condensed consolidated statements of operations and comprehensive loss was allocated as follows (in thousands):

| | Three months ended March 31, | |
|--|------------------------------|----------|
| | 2015 | 2014 |
| Cost of revenue | \$ 29 | \$ 2 |
| Research and development | 122 | 87 |
| General and administrative | 328 | 852 |
| Selling and marketing | 142 | 420 |
| Capitalized into inventory | 39 | 43 |
| Total stock-based compensation expense | \$ 660 | \$ 1,404 |

Unrecognized stock-based compensation at March 31, 2015 was as follows (in thousands):

| | Unrecognized Stock-Based Compensation | Weighted Average Remaining Period of Recognition (in years) |
|---------------|---------------------------------------|---|
| Stock options | \$ 792 | 2.4 |

10. Commitments and Contingencies

From time to time, the Company is subject to various claims and legal proceedings covering matters that arise in the ordinary course of its business activities. Management believes any liability that may ultimately result from the resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, operating results or cash flows.

11. Related-Party Transactions

Gregg R. Honigblum, the Chief Executive Officer of each of Creation Capital, LLC ("Creation Capital") and Creation Capital Advisors, LLC ("Creation Advisors"), served on the Company's board of directors from December 2006 through September 2013. The Company completed offerings of preferred stock and convertible debt through Creation Capital, as its placement agent, and also received strategic financial advisory services from Creation Advisors.

In October 2013, the Company entered into a one-year consulting agreement for financial advisory services with Creation Advisors in which Creation Advisors was to receive compensation of up to \$180,000 in cash (payable \$15,000 per month). The Company paid \$45,000 under this agreement during the three months ended March 31, 2014. This agreement was terminated in March 2014 and as consideration for termination of the agreement, the Company paid \$60,000 and issued 50,000 restricted shares of common stock, valued at \$372,000, to Creation Advisors.

12. Subsequent Events

Subsequent to March 31, 2015, an additional 8,713,766 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 26,279,501 shares of common stock. The remaining Secondary Offering Warrants totaled 3,554,841.

On April 2, 2015, we entered into an Amendment and Exchange Agreement (the "Amendment Agreement") with Magna. The Amendment Agreement provides for the issuance by the Company to Magna of new senior convertible notes (the "Exchange Convertible Notes") in exchange for the Initial Convertible Note, the Additional Convertible Note and a warrant issued to Magna ("Magna Warrant") to purchase 568,889 shares of the Company's common stock at an exercise price of \$4.65. The exchange resulted in the cancellation of the Initial Convertible Note, Additional Convertible Note and Magna Warrant.

The Exchange Convertible Notes have a principal balance of \$4.3 million and are identical in all material respects to the original Convertible Notes except as follows:

Maturity Date. The Exchange Convertible Notes mature on June 30, 2016, provided however, that if, as of June 30, 2016, the Company has satisfied certain equity conditions described in the Exchange Convertible Note, the maturity date shall be extended to June 30, 2017.

Basic Conversion Rights. The Exchange Convertible Notes are convertible at any time after issuance, in whole or in part, at Magna's option, into shares of common stock at an initial conversion price equal to \$1.00 per share. If, however, on May 29, 2015, 120% of the arithmetic average of the volume weighted average price ("VWAP") of the common stock of each Trading Day during the preceding five Trading Day period (the "Adjustment Measuring Price") is greater than \$1.00, then the Conversion Price then in effect shall be adjusted to the Adjustment Measuring Price.

Alternate Conversion. The Exchange Convertible Notes are also alternatively convertible at any time after issuance, in whole or in part, at an alternative conversion price equal to the greater of (x) \$0.20 and (y) the lower of (i) the conversion price then in effect and (ii) a price equal to 80% of the lowest daily VWAP of the common stock during the five consecutive Trading Day period prior to such Conversion Date (the "Alternate Conversion Price").

Make-Whole Issuances. In the event on any conversion date the applicable conversion price for that date is greater than the closing bid price as of the trading day immediately preceding such applicable conversion date (a "Make-Whole Conversion") and, thereafter, the holder fails to resell such shares of common stock at a price greater than such conversion price, the holder may be entitled to a make-whole of additional shares of common stock (the "Make-Whole Shares") with respect to such Make-Whole Conversions. The number of Make-Whole Shares to be issued, if any, with respect to such Make-Whole Conversions shall equal the greater of zero and the quotient of (1) the difference of the (x) the aggregate amount of principal and interest of the Exchange Convertible Note converted into shares of common stock during the applicable quarterly period (which excludes the last three trading days in such calendar quarter and includes the excluded trading days from the prior calendar quarter, if any) in which a Make-Whole Conversion occurred (less the aggregate amount of principal and interest relating to shares of common stock that have not been resold during such applicable quarterly period) minus (y) the aggregate gross consideration received by such holder on the resale of any shares of common stock received by such holder on conversions occurring during

that applicable quarterly period divided by (2) the Alternate Conversion Price on the date of the Make-Whole Conversion. If the Alternate Conversion Price on the date of the Make-Whole Conversion is less than the closing bid price as of the trading day immediately preceding such date, the issuance of the Make-Whole Shares is deemed to be an additional Make-Whole Conversion for all purposes under the Exchange Convertible Note. The Company's obligation to issue additional Make-Whole Shares shall terminate at such time as the aggregate gross consideration received by the holder from the resale of shares of common stock issued on conversions exceeds the sum of the total principal amount of the Exchange Convertible Notes and the sum of all accrued and unpaid interest on such notes.

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 in conjunction with our consolidated financial statements for the year ended December 31, 2014 and the notes thereto, along with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2014, filed separately with the U.S. Securities and Exchange Commission. This discussion and analysis contains forward-looking statements based upon current beliefs, plans, expectations, intentions and projections that involve risks, uncertainties and assumptions, such as statements regarding our plans, objectives, expectations, intentions and projections. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of several factors, including those set forth under the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2014, and any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q, including those set forth under Part II, Item 1A. of this Quarterly Report on Form 10-Q.

Overview

We are a commercial biomaterial company focused on using our silicon nitride technology platform to develop, manufacture and sell a broad range of medical devices. We currently market spinal fusion products and are developing products for use in total hip and knee joint replacements. We believe our silicon nitride technology platform enables us to offer new and transformative products in the orthopedic and other medical device markets. We believe we are the first and only company to use silicon nitride in medical applications. Over 20,000 of our silicon nitride spine products have been implanted in patients.

Biomaterials come in a variety of synthetic or natural materials available in a variety of forms that are used in virtually every medical specialty. We believe our silicon nitride biomaterial has superior characteristics compared to commonly used biomaterials in the markets we are targeting, including polyetheretherketone, or PEEK, which is the most common biomaterial used for interbody spinal fusion products. Specifically, we believe our silicon nitride has the following key attributes: promotion of bone growth; hardness, strength and resistance to fracture; resistance to wear; non-corrosive; anti-infective properties; biocompatibility; and superior diagnostic imaging compatibility.

We currently market our *Valeo*® family of silicon nitride interbody spinal fusion devices in the United States and Europe for use in the cervical and thoracolumbar areas of the spine. We believe our *Valeo* devices have a number of advantages over existing products due to silicon nitride's key characteristics, resulting in faster and more effective fusion and reduced risk of infection.

In addition to our silicon nitride-based spinal fusion products, we market a line of non-silicon nitride spinal fusion products which allows us to provide surgeons and hospitals with a broader range of products. These additional products are complementary to our fusion products and are designed for the treatment of deformity and degenerative spinal procedures. Although our non-silicon nitride products have accounted for approximately 44% and 57% of our product revenues for the years ended March 31, 2015 and 2014, respectively, we believe the continued promotion and potential for adoption of our silicon nitride products and product candidates, if approved, provides us the greatest opportunity to grow our business in new and existing markets and achieve our goal to become a leading biomaterial company.

In addition to the markets into which we directly sell our products, we are utilizing our silicon nitride technology platform to expand our current penetration in the spinal fusion market through original equipment manufacturer ("OEM") and private label partnerships. We also expect to do the same in other markets such as total hip and knee joint replacements, dental and sports medicine. We believe our biomaterial expertise, strong intellectual property and formulaic manufacturing process will allow us to transition currently available medical device products made of inferior biomaterials and manufacture them using silicon nitride and our technology platform to improve their characteristics.

We are also incorporating our silicon nitride technology into components for use in total hip and knee replacement product candidates that we plan on developing in collaboration with a strategic partner. We believe that our silicon nitride total hip and knee product candidates will provide competitive advantages over current products made with traditional biomaterials. We also

[Table of Contents](#)

believe our silicon nitride technology platform can be used for developing products in other markets and have developed prototypes for use in the dental, sports medicine and trauma markets. As a result of some of the key characteristics of our silicon nitride, we also believe our coating technology may be used to enhance our metal products as well as commercially available metal spinal fusion, joint replacement and other medical products.

We operate a 30,000 square foot manufacturing facility located at our corporate headquarters in Salt Lake City, Utah, and we are the only vertically integrated silicon nitride orthopedic medical device manufacturer in the world. We market and sell our products to surgeons and hospitals in the United States and select markets in Europe and South America through our established network of more than 50 independent sales distributors who are managed by our experienced in-house sales and marketing management team. We have also started entering into OEM and private label relationships with third parties to further the commercialization of our silicon nitride technology platform beyond our own direct marketing and selling efforts.

Recent Developments

Restructuring

On January 7, 2015, our Board of Directors authorized the implementation of certain cost saving measures which included a reduction in staff of 25 employees, or approximately 28% of our workforce as the result of a comprehensive business review to improve financial performance, increase operational efficiencies and strengthen the Company's value proposition. The staff reduction was implemented and completed on January 8, 2015.

We recorded one-time severance and related costs related to the restructuring of approximately \$0.6 million in January 2015 and recorded an additional \$0.1 million in severance expense related to additional terminations subsequent to January 2015.

Secondary Offering

On November 26, 2014, we completed a secondary offering, in which we sold and issued 11,441,646 units. Each unit was issued at a price of \$1.14 and consisted of one share of common stock and one common stock warrant ("Secondary Offering Warrant"). We received proceeds of approximately \$11.3 million, net of approximately \$1.7 million in cash underwriting and other offering costs from the secondary offering. We issued an additional 1,716,246 Secondary Offering Warrants pursuant to the exercise of the underwriters' over-allotment option.

The Secondary Offering Warrants were immediately exercisable after issuance into common shares at an exercise price of \$1.48 and terminate on November 26, 2019. The Secondary Offering Warrants contain a cashless exercise provision whereby the holders may exercise warrants by paying the exercise price in cash or, in lieu of payment of the exercise price in cash, at any time 120 days after the November 26, 2014 issuance date, by electing to receive a cash payment from the Company equal to the Black Scholes Value (as defined below) of the number of shares the holder elects to exercise (the "Black Scholes Payment"); provided that we have discretion as to whether to deliver the Black Scholes Payment or, subject to meeting certain conditions, to deliver a number of shares of our common stock determined according to the following formula (the "Cashless Exercise"):

$$\text{Total Shares} = (A \times B) / C$$

Where:

Total Shares is the number of shares of common stock to be issued upon a Cashless Exercise

A is the total number of shares with respect to which the warrant is then being exercised.

B is the Black Scholes Value (as defined below).

C is the closing bid price of our common stock as of two trading days prior to the time of such exercise.

As defined in the Secondary Offering Warrants, "Black Scholes Value" means the Black Scholes value of an option for one share of our common stock at the date of the applicable Black Scholes Payment or Cashless Exercise, which is calculated using the Black Scholes Option Pricing Model obtained from the "OV" function on Bloomberg utilizing (i) an underlying price per share equal to the closing bid price of the common stock as of trading day immediately preceding the date of issuance of the warrant, (ii) a risk-free interest rate corresponding to the U.S. Treasury rate for a period equal to the remaining term of the warrant as of the applicable Black Scholes Payment or Cashless Exercise, (iii) a strike price equal to the exercise price in effect at the time of the applicable Black Scholes Payment or Cashless Exercise, (iv) an expected volatility equal to 135% and (v) a remaining term of such option equal to five years (regardless of the actual remaining term of the warrant).

[Table of Contents](#)

During the three months ended March 31, 2015, 913,145 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 1,717,840 shares of common stock. Subsequent to March 31, 2015, an additional 8,713,766 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 26,279,501 shares of common stock. The remaining Secondary Offering Warrants totaled 3,554,841.

Private Placement of Senior Convertible Notes and Warrant to Magna

On June 30, 2014, we entered into a Securities Purchase Agreement with MG Partners II Ltd. ("Magna"). Pursuant to the terms of the Securities Purchase Agreement, we sold to Magna an initial unsecured senior convertible note ("Initial Convertible Note"), for a purchase price of \$2.5 million. Additionally, on August 11, 2014, Magna purchased an additional unsecured senior convertible note ("Additional Convertible Note"), for a purchase price of \$3.5 million. The Initial Convertible Note and Additional Convertible Note are collectively referred to as the Convertible Notes. In addition, we issued to Magna a warrant ("Magna Warrant"), to purchase up to 568,889 shares of our common stock at an exercise price of \$4.65 per share.

As of May 8, 2015, Magna had converted a total of \$1.7 million of the principal amount of the Convertible Notes into 2,419,982 shares of common stock. The remaining principal amount of the Convertible Notes is \$4.3 million.

Pursuant to the terms of the Securities Purchase Agreement and as required by the rules of The NASDAQ Stock Market, until stockholder approval is obtained, we may not issue any additional shares of common stock upon conversion of the Convertible Notes. Accordingly, in accordance with a Securities Purchase Agreement, we are seeking to obtain stockholder approval to issue shares of common stock equal to 20% or more of our issued and outstanding shares of common stock on June 30, 2014, at a price that may be less than the greater of book or market value of our common stock at the annual meeting of stockholders on May 21, 2015.

On April 2, 2015, we entered into an Amendment and Exchange Agreement (the "Amendment Agreement") with Magna. The Amendment Agreement provides for the issuance by the Company to Magna of new senior convertible notes in exchange for the Initial Convertible Note, the Additional Convertible Note and the Magna Warrant (the "Exchange Convertible Notes"), which exchange resulted in the cancellation of the Initial Convertible Note, Additional Convertible Note and Magna Warrant, certain conforming amendments to the Securities Purchase Agreement and related documents, a reset of the trading price of the Company's common stock at which the trading volume restrictions imposed cease to apply from \$2.50 to \$0.50, and a mutual release of claims.

The Exchange Convertible Notes have a principal balance of \$4.3 million and are identical in all material respects to the Convertible Notes except as follows:

Maturity Date. The Exchange Convertible Notes mature on June 30, 2016, provided however, that if, as of June 30, 2016, the Company has satisfied certain equity conditions described in the Exchange Convertible Note, the maturity date shall be extended to June 30, 2017.

Basic Conversion Rights. The Exchange Convertible Notes are convertible at any time after issuance, in whole or in part, at the Investor's option, into shares of common stock at an initial conversion price equal to \$1.00 per share. If on May 29, 2015, 120% of the arithmetic average of the volume weighted average price ("VWAP") of the common stock of each Trading Day during the preceding five (5) Trading Day period (the "Adjustment Measuring Price") is greater than \$1.00, then the Conversion Price then in effect shall be adjusted to the Adjustment Measuring Price.

Alternate Conversion. The Exchange Convertible Notes are also alternatively convertible at any time after issuance, in whole or in part, at an alternative conversion price equal to the greater of (x) \$0.20 and (y) the lower of (i) the conversion price then in effect and (ii) a price equal to 80% of the lowest daily VWAP of the common stock during the five (5) consecutive Trading Day period prior to such Conversion Date (the "Alternate Conversion Price").

Make-Whole Issuances. In the event on any conversion date the applicable conversion price for that date is greater than the closing bid price as of the trading day immediately preceding such applicable conversion date (a "Make-Whole Conversion") and, thereafter, the holder fails to resell such shares of common stock at a price greater than such conversion price, the holder may be entitled to a make-whole of additional shares of common stock (the "Make-Whole Shares") with respect to such Make-Whole Conversions. The number of Make-Whole Shares to be issued, if any, with respect to such Make-Whole Conversions shall equal the greater of zero and the quotient of (1) the difference of the (x) the aggregate amount of principal and interest of the Exchange Convertible Note converted into shares of common stock during the applicable quarterly period (which excludes the last three trading days in such calendar quarter and includes the excluded trading days from the prior calendar quarter, if any) in which a Make-Whole Conversion occurred (less the aggregate amount of principal and interest relating to shares of common stock that have not been resold during such applicable quarterly period) minus (y) the aggregate gross consideration received by such holder on the resale of any shares of common stock received by such holder on conversions occurring during

that applicable quarterly period divided by (2) the Alternate Conversion Price on the date of the Make-Whole Conversion. If the Alternate Conversion Price on the date of the Make-Whole Conversion is less than the closing bid price as of the trading day immediately preceding such date, the issuance of the Make-Whole Shares is deemed to be an additional Make-Whole Conversion for all purposes under the Exchange Convertible Note. The Company's obligation to issue additional Make-Whole Shares shall terminate at such time as the aggregate gross consideration received by the holder from the resale of shares of common stock issued on conversions exceeds the sum of the total principal amount of the Exchange Convertible Notes and the sum of all accrued and unpaid interest on such notes.

Components of our Results of Operations

We manage our business within one reportable segment, which is consistent with how our management reviews our business, makes investment and resource allocation decisions and assesses operating performance.

Product Revenue

We derive our product revenue primarily from the sale of spinal fusion devices and related products used in the treatment of spine disorders. Our product revenue is generated from sales to two types of customers: (1) surgeons and hospitals; and (2) stocking distributors. Most of our products are sold on a consignment basis through a network of independent sales distributors; however, we also sell our products to independent stocking distributors. Product revenue is recognized when all four of the following criteria are met: (1) persuasive evidence that an arrangement exists; (2) delivery of the products has occurred; (3) the selling price of the product is fixed or determinable; and (4) collectability is reasonably assured. We generate the majority of our revenue from the sale of inventory that is consigned to independent sales distributors that sell our products to surgeons and hospitals. For these products, we recognize revenue at the time we are notified the product has been used or implanted and all other revenue recognition criteria have been met. For all other transactions, we recognize revenue when title and risk of loss transfer to the stocking distributor, and all other revenue recognition criteria have been met. We generally recognize revenue from sales to stocking distributors at the time the product is shipped to the distributor. Stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership at time of shipment. Our stocking distributors are obligated to pay within specified terms regardless of when, if ever, they sell the products. Our policy is to classify shipping and handling costs billed to customers as an offset to total shipping expense in the statement of operations, primarily within sales and marketing. In general, our customers do not have any rights of return or exchange.

We believe our product revenue from the sale of our silicon nitride based products will increase due to our sales and marketing efforts and as we introduce new silicon nitride based products into the market and product revenue from the sale of our non-silicon nitride products to decrease. We expect that our product revenue will continue to be primarily attributable to sales of our products in the United States.

Cost of Revenue

The expenses that are included in cost of revenue include all direct product costs if we obtained the product from third-party manufacturers and our in-house manufacturing costs for the products we manufacture. We obtain our non-silicon nitride products, including our metal and orthobiologic products, from third-party manufacturers, while we currently manufacture our silicon-nitride products in-house.

Specific provisions for excess or obsolete inventory and, beginning in 2013, the excise tax on the sale of medical devices in the United States, are also included in cost of revenue. In addition, we pay royalties attributable to the sale of specific products to some of our surgeon advisors that assisted us in the design, regulatory clearance or commercialization of a particular product, and these payments are recorded as cost of revenue.

Gross Profit

Our gross profit measures our product revenue relative to our cost of revenue. We expect our gross profit to decrease as we expand the penetration of our silicon nitride technology platform through OEM and private label partnerships.

Research and Development Expenses

Our net research and development costs are expensed as incurred. Research and development costs consist of engineering, product development, clinical trials, test-part manufacturing, testing, developing and validating the manufacturing process, manufacturing, facility and regulatory-related costs. Research and development expenses also include employee compensation, employee and non-employee stock-based compensation, supplies and materials, consultant services, and travel and facilities

[Table of Contents](#)

expenses related to research activities. To the extent that certain research and development expenses are directly related to our manufactured products, such expenses and related overhead costs are allocated to inventory.

We expect to incur additional research and development costs as we continue to develop new spinal fusion products, our product candidates for total joint replacements, such as our total hip replacement product candidate, and our silicon nitride-coated metals which may increase our total research and development expenses.

Sales and Marketing Expenses

Sales and marketing expenses consist of salaries, benefits and other related costs, including stock-based compensation, for personnel employed in sales, marketing, medical education and training. In addition, our sales and marketing expenses include commissions and bonuses, generally based on a percentage of sales, to our sales managers and independent sales distributors. We provide our products in kits or banks that consist of a range of device sizes and separate instruments necessary to complete the surgical procedure. We generally consign our instruments to our distributors or our hospital customers that purchase the device used in spinal fusion surgery. Our sales and marketing expenses include depreciation of the surgical instruments.

We expect our sales and marketing expenses will remain flat or slightly decline due to the cost saving measures implemented during the first quarter. Additionally, we expect our commissions to increase in absolute terms over time but remain approximately the same or decrease as a percentage of product revenue.

General and Administrative Expenses

General and administrative expenses primarily consist of salaries, benefits and other related costs, including stock-based compensation, for certain members of our executive team and other personnel employed in finance, legal, compliance, administrative, information technology, customer service, executive and human resource departments. General and administrative expenses include allocated facility expenses, related travel expenses and professional fees for accounting and legal services.

We expect our general and administrative expenses to decrease as a result of the restructuring and cost saving measures implemented during the first quarter of 2015.

RESULTS OF OPERATIONS

The following is a tabular presentation of our condensed consolidated operating results for the three months ended March 31, 2015 compared to our condensed consolidated operating results for the three months ended March 31, 2014 (*in thousands*):

| | Three Months Ended March 31, | | | |
|------------------------------|------------------------------|------------|------------|----------|
| | 2015 | 2014 | \$ Change | % Change |
| Product revenue | \$ 4,743 | \$ 5,780 | \$ (1,037) | (18)% |
| Costs of revenue | 1,522 | 1,649 | (127) | (8)% |
| Gross profit | 3,221 | 4,131 | (910) | (22)% |
| Operating expenses: | | | | |
| Research and development | 1,843 | 591 | 1,252 | 212 % |
| General and administrative | 2,027 | 3,075 | (1,048) | (34)% |
| Sales and marketing | 3,357 | 4,521 | (1,164) | (26)% |
| Total operating expenses | 7,227 | 8,187 | (960) | (12)% |
| Loss from operations | (4,006) | (4,056) | 50 | (1)% |
| Other income (expense), net | (1,375) | (657) | (718) | (109)% |
| Net loss before income taxes | (5,381) | (4,713) | (668) | (14)% |
| Provision for income taxes | — | — | — | — % |
| Net loss | \$ (5,381) | \$ (4,713) | \$ (668) | (14)% |

[Table of Contents](#)*Product Revenue*

The following table sets forth our product revenue from sales of the indicated product category for the three months ended March 31, 2015 and 2014 (in thousands):

| | Three Months Ended March 31, | | | |
|-----------------------|------------------------------|----------|------------|----------|
| | 2015 | 2014 | \$ Change | % Change |
| Silicon Nitride | \$ 2,658 | \$ 2,487 | \$ 171 | 7 % |
| Non-Silicon Nitride | 2,085 | 3,293 | (1,208) | (37)% |
| Total product revenue | \$ 4,743 | \$ 5,780 | \$ (1,037) | (18)% |

For the three months ended March 31, 2015, total product revenue decreased \$1.0 million, or 18%, as compared to the same period in 2014. The decrease was primarily due to decreased sales of our non-silicon nitride products, which decreased by \$1.2 million, or 37%, for the three months ended March 31, 2015 as compared to the same period in 2014. This decline was primarily due to lower metals sales as a result of a decline in the level of activity for a few key surgeons and our continued focus and investment in sales and marketing efforts of our silicon nitride products. Silicon nitride sales increased by \$171,000 or 7%, as compared to the same period in 2014.

The following table sets forth, for the periods indicated, our product revenue by geographic area (in thousands):

| | Three Months Ended March 31, | | | |
|-----------------------|------------------------------|----------|------------|----------|
| | 2015 | 2014 | \$ Change | % Change |
| Domestic | \$ 4,732 | \$ 5,775 | \$ (1,043) | (18)% |
| International | 11 | 5 | 6 | 120 % |
| Total product revenue | \$ 4,743 | \$ 5,780 | \$ (1,037) | (18)% |

International revenue was relatively flat for the three months ended March 31, 2015 as compared to the same periods in 2014, as we have primarily focused on increasing domestic sales.

Cost of Revenue and Gross Profit

For the three months ended March 31, 2015, our cost of revenue decreased \$127,000, or 8%, as compared to the same period in 2014. The decrease in cost of revenue was primarily a result of reduced sales for the three months ended March 31, 2015 as compared to the same period in 2014. Although we have reduced our product costs through production efficiencies and lower overhead costs, our gross profit as a percentage of product revenue decreased by 4% to 68% for the three months ended March 31, 2015 from 72% for the same period in 2014 as a result of revenue recognized from private label sales during 2015, which has lower gross margins due to lower selling prices.

Research and Development Expenses

For the three months ended March 31, 2015, research and development expenses increased \$1.3 million, or 212%, as compared to the same period in 2014. This increase was primarily due to a \$1.8 million increase in operating expenses that could not be allocated to inventory because we produced a lower amount of our *Valeo* products during the three month period ended March 31, 2015 than in the same period in 2014. In 2014, as a result of the ramp-up phase for our second generation *Valeo* products, these overhead costs had previously been allocated to inventory. The increase was offset by decreases in personnel related expenses and other research and development expenditures.

General and Administrative Expenses

For the three months ended March 31, 2015, general and administrative expenses decreased \$1.0 million, or 34.1%, as compared to the same period in 2014. This decrease was primarily due to a \$0.5 million decrease in stock-based compensation and a \$0.7 million decrease in consulting, professional services, legal, patent and other general operating expenses as we have reduced operating costs in 2015. The decreases were offset by an increase in personnel related costs of \$0.2 million related to severance expenses incurred during the first quarter of 2015.

Sales and Marketing Expenses

For the three months ended March 31, 2015, sales and marketing expenses decreased \$1.2 million, or 25.7%, as compared to the same period in 2014. This decrease was primarily due to a \$0.7 million decrease in commissions, a \$0.3 million decrease in stock compensation, and a \$0.2 million decrease in consulting and other operating expenses as we have reduced operating costs

[Table of Contents](#)

in 2015. The decreases were offset by an increase in personnel related costs of \$0.2 million related to severance expenses incurred during the first quarter of 2015.

Other Income (Expense), Net

For the three months ended March 31, 2015, other expense increased \$0.7 million, or 109%, as compared to the same period in 2014. This increase was primarily due to a \$0.6 million increase in interest expense from the additional debt incurred during the second quarter of 2014 and an increase of \$0.1 million from the change in fair value of our derivative liabilities.

Liquidity and Capital Resources

For the three months ended March 31, 2015 and 2014, we incurred a net loss of \$5.4 million and \$4.7 million, respectively, and used cash in operations of \$3.0 million and \$2.0 million, respectively. We have an accumulated deficit of \$177.9 million as of March 31, 2015. To date, our operations have been principally financed from proceeds from the issuance of convertible preferred stock and common stock, convertible debt and bank debt and, to a lesser extent, cash generated from product sales. As of March 31, 2015, we had approximately \$14.9 million in cash and cash equivalents.

In order to help finance our operations and maintain compliance with our Hercules debt covenants, we completed a secondary offering in November 2014, in which we sold and issued 11,441,646 units. Each unit was issued at a price of \$1.14 and consisted of one share of common stock and one Secondary Offering Warrant. We received proceeds of approximately \$11.3 million, net of approximately \$1.7 million in cash underwriting and other offering costs from the secondary offering. We issued an additional 1,716,246 Secondary Offering Warrants pursuant to the underwriters' over-allotment option.

The Secondary Offering Warrants were immediately exercisable after issuance into common shares at an exercise price of \$1.48 and terminate on November 26, 2019. The Secondary Offering Warrants contain a cashless exercise provision whereby the holders may exercise warrants by paying the exercise price in cash or, in lieu of payment of the exercise price in cash, at any time 120 days after the November 26, 2015 issuance date, by electing to receive a cash payment from the Company equal to the Black Scholes Value (as defined below) of the number of shares the holder elects to exercise the Black Scholes Payment; provided that we have discretion as to whether to deliver the Black Scholes Payment or, subject to meeting certain conditions, to deliver a number of shares of our common stock determined according to the following formula:

$$\text{Total Shares} = (A \times B) / C$$

Where:

Total Shares is the number of shares of common stock to be issued upon a Cashless Exercise

A is the total number of shares with respect to which the warrant is then being exercised.

B is the Black Scholes Value (as defined below).

C is the closing bid price of our common stock as of two trading days prior to the time of such exercise.

As defined in the Secondary Offering Warrants, "Black Scholes Value" means the Black Scholes value of an option for one share of our common stock at the date of the applicable Black Scholes Payment or Cashless Exercise, which is calculated using the Black Scholes Option Pricing Model obtained from the "OV" function on Bloomberg utilizing (i) an underlying price per share equal to the closing bid price of the common stock as of trading day immediately preceding the date of issuance of the warrant, (ii) a risk-free interest rate corresponding to the U.S. Treasury rate for a period equal to the remaining term of the warrant as of the applicable Black Scholes Payment or Cashless Exercise, (iii) a strike price equal to the exercise price in effect at the time of the applicable Black Scholes Payment or Cashless Exercise, (iv) an expected volatility equal to 135% and (v) a remaining term of such option equal to five years (regardless of the actual remaining term of the warrant).

During the three months ended March 31, 2015, 913,145 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 1,717,840 shares of common stock. Subsequent to March 31, 2015, an additional 8,713,766 of the Secondary Offering Warrants had been exercised via the cashless exercise provision resulting in the issuance of 26,279,501 shares of common stock. The remaining Secondary Offering Warrants total 3,554,841.

In June 2014 we entered into a Loan and Security Agreement ("Hercules Term Loan") with Hercules Technology Growth Capital, Inc., ("Hercules Technology"), as administrative and collateral agent for the lenders thereunder and as lender, and Hercules Technology III, LP, as lender. The Hercules Term Loan provides for a \$20 million term loan that matures on January 1, 2018 and is secured by substantially all of our assets.

[Table of Contents](#)

The Hercules Term Loan bears interest at the rate of the greater of either (i) the prime rate plus 7.7%, and (ii) 10.95%. Interest accrues from the date of the Hercules Term Loan with interest payments due monthly commencing on July 1, 2014. Principal payments are required commencing August 1, 2015 and are to be made in thirty equal installments, with the remainder due at maturity; provided, however, in the event that we meet certain conditions set forth in the Hercules Term Loan, the interest only period may be extended through February 1, 2016, reducing the number of required principal payments to twenty-four. Additionally, under certain circumstances we may, or Hercules Technology may, require that we repay a portion of the principal in the form of shares of our common stock. The conversion price used for the calculation of the amount of shares to be delivered in such instance is \$5.72 per share.

The Hercules Term Loan contains certain covenants related to restrictions on payments to certain company affiliates, financial reporting requirements and a minimum liquidity covenant that requires us to maintain cash and cash equivalents of no less than \$9.0 million.

We anticipate we will need to obtain additional funding in the fourth quarter of 2015 to maintain compliance with the financial and liquidity covenants related to the Loan and Security Agreement through the next twelve months. Furthermore, if we are unable to access additional funds prior to becoming non-compliant with the financial or liquidity covenants, the entire remaining balance of the Loan and Security Agreement could become immediately due and payable at the option of Hercules Technology. As such, we have classified the entire debt obligation as a current liability.

The repayment of our obligations under the Hercules Term Loan and the liquidity covenant limit our ability to use our cash and cash equivalents to fund our operations and may restrict our ability to continue development of our product candidates. Additionally, the Hercules Term Loan restricts our ability to incur additional pari passu indebtedness, which may reduce our ability to seek additional financing. If adequate funds are not available on a timely basis, we may terminate or delay the development of one or more of our product candidates, or delay activities necessary to commercialize our product candidates. Additional funding may not be available to us on acceptable terms, or at all. Any additional equity financing, if available, may not be available on favorable terms and will most likely be dilutive to our current stockholders, and debt financing, if available, may involve more restrictive covenants. Our ability to access capital when needed is not assured and, if not achieved on a timely basis, will materially harm our business, financial condition and results of operations. As a result of our debt obligations, we will need additional funds to meet our operational needs and capital requirements for product development, clinical trials and commercialization.

On June 30, 2014, we entered into a Securities Purchase Agreement with Magna. Pursuant to the terms of the Securities Purchase Agreement, we sold to Magna the Initial Convertible Note, for a purchase price of \$2.5 million. Additionally, on August 11, 2014, Magna purchased an Additional Convertible Note, for a purchase price of \$3.5 million. The Initial Convertible Note and Additional Convertible Note are collectively referred to as the Convertible Notes. In addition, we issued the Magna Warrant to purchase up to 568,889 shares of our common stock at an exercise price of \$4.65 per share.

As of May 8, 2015, Magna had converted a total of \$1.7 million of the principal amount of the Convertible Notes into 2,419,982 shares of common stock. The remaining principal amount of the Convertible Notes is \$4.3 million.

Pursuant to the terms of the Securities Purchase Agreement and as required by the rules of The NASDAQ Stock Market, until stockholder approval is obtained, we may not issue any additional shares of common stock upon conversion of the Convertible Notes. Accordingly, in accordance with a Securities Purchase Agreement, we are seeking to obtain stockholder approval to issue shares of common stock equal to 20% or more of our issued and outstanding shares of common stock on June 30, 2014, at a price that may be less than the greater of book or market value of our common stock at the annual meeting of stockholders on May 21, 2015.

On April 2, 2015, we entered into the Amendment Agreement with Magna. The Amendment Agreement provides for the issuance by the Company to Magna of the Exchange Convertible Notes in exchange for the Initial Convertible Note, the Additional Convertible Note and the Magna Warrant, which exchange resulted in the cancellation of the Initial Convertible Note, Additional Convertible Note and Magna Warrant, certain conforming amendments to the Securities Purchase Agreement and related documents, a reset of the trading price of the Company's common stock at which the trading volume restrictions imposed cease to apply from \$2.50 to \$0.50, and a mutual release of claims.

The Exchange Convertible Notes have a principal balance of \$4.3 million and are identical in all material respects to the Convertible Notes except as follows:

Maturity Date. The Exchange Convertible Notes mature on June 30, 2016, provided however, that if, as of June 30, 2016, the Company has satisfied certain equity conditions described in the Exchange Convertible Note, the maturity date shall be extended to June 30, 2017.

[Table of Contents](#)

Basic Conversion Rights. The Exchange Convertible Notes are convertible at any time after issuance, in whole or in part, at the Investor's option, into shares of common stock at an initial conversion price equal to \$1.00 per share. If on May 29, 2015, 120% of the arithmetic average of the volume weighted average price ("VWAP") of the common stock of each Trading Day during the preceding five (5) Trading Day period (the "Adjustment Measuring Price") is greater than \$1.00, then the Conversion Price then in effect shall be adjusted to the Adjustment Measuring Price.

Alternate Conversion. The Exchange Convertible Notes are also alternatively convertible at any time after issuance, in whole or in part, at an alternative conversion price equal to the greater of (x) \$0.20 and (y) the lower of (i) the conversion price then in effect and (ii) a price equal to 80% of the lowest daily VWAP of the common stock during the five (5) consecutive Trading Day period prior to such Conversion Date (the "Alternate Conversion Price").

Make-Whole Issuances. In the event on any conversion date the applicable conversion price for that date is greater than the closing bid price as of the trading day immediately preceding such applicable conversion date (a "Make-Whole Conversion") and, thereafter, the holder fails to resell such shares of common stock at a price greater than such conversion price, the holder may be entitled to a make-whole of additional shares of common stock (the "Make-Whole Shares") with respect to such Make-Whole Conversions. The number of Make-Whole Shares to be issued, if any, with respect to such Make-Whole Conversions shall equal the greater of zero and the quotient of (1) the difference of the (x) the aggregate amount of principal and interest of the Exchange Convertible Note converted into shares of common stock during the applicable quarterly period (which excludes the last three trading days in such calendar quarter and includes the excluded trading days from the prior calendar quarter, if any) in which a Make-Whole Conversion occurred (less the aggregate amount of principal and interest relating to shares of common stock that have not been resold during such applicable quarterly period) minus (y) the aggregate gross consideration received by such holder on the resale of any shares of common stock received by such holder on conversions occurring during that applicable quarterly period divided by (2) the Alternate Conversion Price on the date of the Make-Whole Conversion. If the Alternate Conversion Price on the date of the Make-Whole Conversion is less than the closing bid price as of the trading day immediately preceding such date, the issuance of the Make-Whole Shares is deemed to be an additional Make-Whole Conversion for all purposes under the Exchange Convertible Note. The Company's obligation to issue additional Make-Whole Shares shall terminate at such time as the aggregate gross consideration received by the holder from the resale of shares of common stock issued on conversions exceeds the sum of the total principal amount of the Exchange Convertible Notes and the sum of all accrued and unpaid interest on such notes.

We will need to from time-to-time seek additional financing through the issuance of common stock and/or debt, to satisfy our debt obligations, meet our working capital requirements, make continued investment in research and development and make capital expenditures needed for us to maintain and expand our business. We may not be able to obtain additional financing on terms favorable to us, if at all. It is also possible that we may allocate significant amounts of capital toward solutions or technologies for which market demand is lower than anticipated and, as a result, abandon such efforts. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, or if we expend capital on projects that are not successful, our ability to continue to support our business growth and to respond to business challenges could be significantly limited, or we may even have to scale back our operations. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock.

Going Concern

Our ability to access capital when needed is not assured and, if not achieved on a timely basis, will materially harm our business, financial condition and results of operations. These uncertainties create substantial doubt about our ability to continue as a going concern. Our independent registered public accounting firm included an explanatory paragraph regarding substantial doubt about our ability to continue as a going concern in their report on our annual financial statements for the fiscal year ended December 31, 2014. The financial information throughout this quarterly report have been prepared on a basis which assumes that we will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. This financial information and statements do not include any adjustments that may result from the outcome of this uncertainty.

Cash Flows

The following table summarizes, for the periods indicated, cash flows from operating, investing and financing activities (in thousands):

| | Three Months Ended March 31, | |
|---|------------------------------|------------------|
| | 2015 | 2014 |
| Net cash used in operating activities | (2,971) | (2,001) |
| Net cash used in investing activities | (274) | (590) |
| Net cash provided by (used in) financing activities | (120) | 13,569 |
| Net cash provided (used) | <u>\$ (3,365)</u> | <u>\$ 10,978</u> |

Net Cash Used in Operating Activities

Net cash used in operating activities was \$3.0 million during the three months ended March 31, 2015, compared to \$2.0 million for the same period in 2014, an increase of \$1.0 million. The increase in cash used in operating activities during 2015 was primarily attributable to \$0.7 million paid for severance and benefits for terminated employees during the three months ended March 31, 2015. Additionally, there was an increase of \$0.3 million in prepaid expenses and other current assets.

Net Cash Used in Investing Activities

Net cash used in investing activities was \$0.3 million during the three months ended March 31, 2015, compared to \$0.6 million used in investing activities during the same period in 2014, a decrease of \$0.3 million. The decrease in net cash used in investing activities during 2015 was primarily attributable to decreased purchases of property and equipment of \$0.3 million during 2015 as compared to 2014.

Net Cash Used in or Provided by Financing Activities

Net cash used in financing activities was \$0.1 million during the three months ended March 31, 2015, compared to \$13.6 million provided during the same period in 2014, a decrease of \$13.7 million. In 2015, we repurchased shares related to the vesting of certain management restricted stock units by paying the employee withholding tax associated with the vesting and withholding 206,380 shares of common stock. The cash provided by financing activities in 2014 was primarily attributable to receiving \$15.4 million in net proceeds from the issuance of common stock in our IPO, which were offset by long-term debt payments of \$1.8 million.

Indebtedness

On June 30, 2014, we entered into the Hercules Term Loan, which provides for a \$20 million term loan with a maturity date of January 1, 2018 and is secured by substantially all of our assets.

The Hercules Term Loan bears interest at the rate of the greater of either (i) the prime rate plus 7.7%, and (ii) 10.95%. Interest accrues from the date of the Hercules Term Loan with interest payments due monthly commencing on July 1, 2014. Principal payments are required commencing August 1, 2015 and are to be made in thirty equal installments, with the remainder due at maturity; provided, however, in the event that we meet certain conditions set forth in the Hercules Term Loan, the interest only period may be extended through February 1, 2016, reducing the number of required principal payments to twenty-four.

The Hercules Term Loan contains certain covenants related to restrictions on payments to certain company affiliates, financial reporting requirements and a minimum liquidity covenant that requires us to maintain cash and cash equivalents of no less than \$9.0 million.

We anticipate we will need to obtain additional funding in the fourth quarter of 2015 to maintain compliance with the financial and liquidity covenants related to the Loan and Security Agreement through the next twelve months. Furthermore, if we are unable to access additional funds prior to becoming non-compliant with the financial or liquidity covenants, the entire remaining balance of the Loan and Security Agreement could become immediately due and payable at the option of Hercules Technology. As such, we have classified the entire debt obligation as a current liability.

Also, on June 30, 2014, we entered into a Securities Purchase Agreement with Magna. Pursuant to the terms of the Securities Purchase Agreement, we sold to Magna the Initial Convertible Note, for a purchase price of \$2.5 million. Additionally, on August 11, 2014, Magna purchased an Additional Convertible Note, for a purchase price of \$3.5 million. The Initial Convertible Note and Additional Convertible Note are collectively referred to as the Convertible Notes. In addition, we issued the Magna Warrant to purchase up to 568,889 shares of our common stock at an exercise price of \$4.65 per share.

[Table of Contents](#)

As of May 8, 2015, Magna had converted a total of \$1.7 million of the principal amount of the Convertible Notes into 2,419,982 shares of common stock. The remaining principal amount of the Convertible Notes is \$4.3 million.

Pursuant to the terms of the Securities Purchase Agreement and as required by the rules of The NASDAQ Stock Market, until stockholder approval is obtained, we may not issue any additional shares of common stock upon conversion of the Convertible Notes. Accordingly, in accordance with a Securities Purchase Agreement, we are seeking to obtain stockholder approval to issue shares of common stock equal to 20% or more of our issued and outstanding shares of common stock on June 30, 2014, at a price that may be less than the greater of book or market value of our common stock at the annual meeting of stockholders on May 21, 2015.

On April 2, 2015, we entered into the Amendment Agreement with Magna. The Amendment Agreement provides for the issuance by the Company to Magna of the Exchange Convertible Notes in exchange for the Initial Convertible Note, the Additional Convertible Note and the Magna Warrant, which exchange resulted in the cancellation of the Initial Convertible Note, Additional Convertible Note and Magna Warrant, certain conforming amendments to the Securities Purchase Agreement and related documents, a reset of the trading price of the Company's common stock at which the trading volume restrictions imposed cease to apply from \$2.50 to \$0.50, and a mutual release of claims.

The Exchange Convertible Notes have a principal balance of \$4.3 million and are identical in all material respects to the Convertible Notes except as follows:

Maturity Date. The Exchange Convertible Notes mature on June 30, 2016, provided however, that if, as of June 30, 2016, the Company has satisfied certain equity conditions described in the Exchange Convertible Note, the maturity date shall be extended to June 30, 2017.

Basic Conversion Rights. The Exchange Convertible Notes are convertible at any time after issuance, in whole or in part, at the Investor's option, into shares of common stock at an initial conversion price equal to \$1.00 per share. If on May 29, 2015, 120% of the arithmetic average of the volume weighted average price ("VWAP") of the common stock of each Trading Day during the preceding five (5) Trading Day period (the "Adjustment Measuring Price") is greater than \$1.00, then the Conversion Price then in effect shall be adjusted to the Adjustment Measuring Price.

Alternate Conversion. The Exchange Convertible Notes are also alternatively convertible at any time after issuance, in whole or in part, at an alternative conversion price equal to the greater of (x) \$0.20 and (y) the lower of (i) the conversion price then in effect and (ii) a price equal to 80% of the lowest daily VWAP of the common stock during the five (5) consecutive Trading Day period prior to such Conversion Date (the "Alternate Conversion Price").

Make-Whole Issuances. In the event on any conversion date the applicable conversion price for that date is greater than the closing bid price as of the trading day immediately preceding such applicable conversion date (a "Make-Whole Conversion") and, thereafter, the holder fails to resell such shares of common stock at a price greater than such conversion price, the holder may be entitled to a make-whole of additional shares of common stock (the "Make-Whole Shares") with respect to such Make-Whole Conversions. The number of Make-Whole Shares to be issued, if any, with respect to such Make-Whole Conversions shall equal the greater of zero and the quotient of (1) the difference of the (x) the aggregate amount of principal and interest of the Exchange Convertible Note converted into shares of common stock during the applicable quarterly period (which excludes the last three trading days in such calendar quarter and includes the excluded trading days from the prior calendar quarter, if any) in which a Make-Whole Conversion occurred (less the aggregate amount of principal and interest relating to shares of common stock that have not been resold during such applicable quarterly period) minus (y) the aggregate gross consideration received by such holder on the resale of any shares of common stock received by such holder on conversions occurring during that applicable quarterly period divided by (2) the Alternate Conversion Price on the date of the Make-Whole Conversion. If the Alternate Conversion Price on the date of the Make-Whole Conversion is less than the closing bid price as of the trading day immediately preceding such date, the issuance of the Make-Whole Shares is deemed to be an additional Make-Whole Conversion for all purposes under the Exchange Convertible Note. The Company's obligation to issue additional Make-Whole Shares shall terminate at such time as the aggregate gross consideration received by the holder from the resale of shares of common stock issued on conversions exceeds the sum of the total principal amount of the Exchange Convertible Notes and the sum of all accrued and unpaid interest on such notes.

See "Liquidity and Capital Resources" above for additional information about the Hercules Term Loan and the Convertible Notes.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as defined in Item 303(a)(4) of Regulation S-K.

Critical Accounting Policies and Estimates

A summary of our significant accounting policies and estimates is discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no material changes to those policies during the three months ended March 31, 2015. The preparation of the financial statements in accordance with U.S. generally accepted accounting principles requires us to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities. Significant areas of uncertainty that require judgments, estimates and assumptions include the accounting for income taxes and other contingencies as well as valuation of derivative liabilities, asset impairment and collectability of accounts receivable. We use historical and other information that we consider to be relevant to make these judgments and estimates. However, actual results may differ from those estimates and assumptions that are used to prepare our financial statements.

New Accounting Pronouncements

See discussion under Note 1, *Organization and Summary of Significant Accounting Policies*, to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q, for information on new accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

This Report includes the certifications of our Chief Executive Officer and Principal Accounting Officer required by Rule 13a-14 of the Securities Exchange Act of 1934 (the "Exchange Act"). See Exhibits 31.1 and 31.2. This Item 4 includes information concerning the controls and control evaluations referred to in those certifications.

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in rules and forms adopted by the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Principal Accounting Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this report, our management, under the supervision and with the participation of our Chief Executive Officer and our Principal Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Principal Accounting Officer have concluded that our disclosure controls and procedures were effective as of March 31, 2015.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the first quarter of 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

We are not aware of any pending or threatened legal proceeding against us that could have a material adverse effect on our business, operating results or financial condition. The medical device industry is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, we may be involved in various additional legal proceedings from time to time.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission on March 24, 2015.

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

Unregistered Sales of Equity Securities

On January 22, 2015, we issued 30,000 shares of our common stock to a service provider for services with respect to certain corporate development activities. The sales and issuances of these securities were exempt from registration under the Securities Act in reliance upon Section 4(2) of the Securities Act, as transactions by an issuer not involving any public offering. The recipient represented its intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and an appropriate legend was placed upon the stock certificate issued in this transaction. No underwriter was involved in this transaction.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

[Table of Contents](#)

| Exhibit Number | Exhibit Description | Filed Herewith | Incorporated by Reference herein from Form or Schedule | Filing Date | SEC File/Reg. Number |
|-----------------------|---|-----------------------|---|--------------------|-----------------------------|
| 4.1 | Senior Convertible Note by Amedica Corporation payable to MG Partners II, Ltd., Issuance Date: June 30, 2014, Exchange Date: April 2, 2015, principle amount of U.S. \$797,649.54. | | Form 8-K (Exhibit 4.1) | 4/3/2015 | 001-33624 |
| 4.2 | Senior Convertible Note by Amedica Corporation payable to MG Partners II, Ltd., Issuance Date: August 12, 2014, Exchange Date: April 2, 2015, principle amount of U.S. \$3,500,000. | | Form 8-K (Exhibit 4.2) | 4/03/15 | 001-33624 |
| 10.1 | Amendment and Exchange Agreement, dated April 2, 2015, by and between the Company and MG Partners II Ltd. | | Form 8-K (Exhibit 4.2) | 4/03/15 | 001-33624 |
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 31.2 | Certification of the Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 32 | Certifications of the Chief Executive Officer and Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 101.INS | XBRL Instance Document | X | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | X | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | X | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | X | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | X | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | X | | | |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMEDICA CORPORATION

Date: May 8, 2015

/s/ B. Sonny Bal

B. Sonny Bal
Chief Executive Officer
(Principal Executive Officer)

Date: May 8, 2015

/s/ Ty A. Lombardi

Ty A. Lombardi
Vice President Finance
(Principal Accounting Officer)

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Ty A. Lombardi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Amedica Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: May 8, 2015

/s/ Ty A. Lombardi

Ty A. Lombardi
Principal Accounting Officer

CERTIFICATIONS UNDER SECTION 906

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Amedica Corporation., a Delaware corporation (the “Company”), does hereby certify, to such officer’s knowledge, that:

The quarterly report for the quarter ended March 31, 2015 (the “Form 10-Q”) of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2015

/s/ B. Sonny Bal

B. Sonny Bal
Chief Executive Officer

Date: May 8, 2015

/s/ Ty A. Lombardi

Ty A. Lombardi
Principal Accounting Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Ty A. Lombardi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Amedica Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: May 8, 2015

/s/ Ty A. Lombardi

Ty A. Lombardi
Principal Accounting Officer

CERTIFICATIONS UNDER SECTION 906

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Amedica Corporation., a Delaware corporation (the “Company”), does hereby certify, to such officer’s knowledge, that:

The quarterly report for the quarter ended March 31, 2015 (the “Form 10-Q”) of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 8, 2015

/s/ B. Sonny Bal

B. Sonny Bal
Chief Executive Officer

Date: May 8, 2015

/s/ Ty A. Lombardi

Ty A. Lombardi
Principal Accounting Officer