

Penumbra Inc
Form 10-Q
August 07, 2018

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 001-37557

Penumbra, Inc.

(Exact name of registrant as specified in its charter)

Delaware 05-0605598
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

One Penumbra Place 94502
Alameda, CA
(Address of principal executive offices) (Zip code)

(510) 748-3200

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: 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 a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

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As of July 24, 2018, the registrant had 34,379,354 shares of common stock, par value \$0.001 per share, outstanding.

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Signatures

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

Penumbra, Inc.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$59,705	\$ 50,637
Marketable investments	147,185	163,954
Accounts receivable, net of doubtful accounts of \$1,571 and \$1,290 at June 30, 2018 and December 31, 2017, respectively	74,059	58,007
Inventories	97,556	94,901
Prepaid expenses and other current assets	13,994	14,735
Total current assets	392,499	382,234
Property and equipment, net	33,719	30,899
Intangible assets, net	27,344	23,778
Goodwill	7,977	8,178
Long-term investments (Note 3)	2,597	3,872
Deferred taxes	34,129	26,690
Other non-current assets	1,049	1,016
Total assets	\$499,314	\$ 476,667
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$7,432	\$ 6,757
Accrued liabilities	42,255	44,825
Total current liabilities	49,687	51,582
Deferred rent	7,430	6,199
Other non-current liabilities	16,998	18,478
Total liabilities	74,115	76,259
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	34	33
Additional paid-in capital	404,493	396,810
Accumulated other comprehensive (loss) income	(661) 1,569
Retained earnings	21,333	1,996
Total stockholders' equity	425,199	400,408
Total liabilities and stockholders' equity	\$499,314	\$ 476,667
See accompanying notes to the unaudited condensed consolidated financial statements		

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Penumbra, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(unaudited)

(in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	\$ 109,638	\$ 80,589	\$ 212,339	\$ 153,802
Cost of revenue	37,386	29,660	73,530	55,164
Gross profit	72,252	50,929	138,809	98,638
Operating expenses:				
Research and development	8,193	8,094	16,206	15,128
Sales, general and administrative	54,776	44,163	109,275	86,884
Total operating expenses	62,969	52,257	125,481	102,012
Income (loss) from operations	9,283	(1,328)	13,328	(3,374)
Interest income, net	720	624	1,469	1,268
Other expense, net	(340)	(214)	(630)	(563)
Income (loss) before income taxes and equity in losses of unconsolidated investee	9,663	(918)	14,167	(2,669)
(Benefit from) provision for income taxes	(4,948)	482	(6,886)	1,837
Income (loss) before equity in losses of unconsolidated investee	14,611	(1,400)	21,053	(4,506)
Equity in losses of unconsolidated investee	(1,230)	(158)	(2,181)	(158)
Net income (loss)	13,381	(1,558)	18,872	(4,664)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments, net of tax	(3,400)	(766)	(2,014)	(74)
Net change in unrealized (losses) gains on available-for-sale securities, net of tax	102	(3)	(216)	67
Total other comprehensive loss, net of tax	(3,298)	(769)	(2,230)	(7)
Comprehensive income (loss)	\$ 10,083	\$ (2,327)	\$ 16,642	\$ (4,671)
Net income (loss)	\$ 13,381	\$ (1,558)	\$ 18,872	\$ (4,664)
Net income (loss) per share:				
Basic	\$ 0.39	\$ (0.05)	\$ 0.56	\$ (0.14)
Diluted	\$ 0.37	\$ (0.05)	\$ 0.52	\$ (0.14)
Weighted average shares used to compute net income (loss) per share:				
Basic	34,072,223	33,219,487	33,959,997	32,420,105
Diluted	36,116,254	33,219,487	36,030,304	32,420,105

See accompanying notes to the unaudited condensed consolidated financial statements

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Penumbra, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Six Months Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$18,872	\$(4,664)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,948	1,422
Amortization of premium on marketable investments	—	436
Stock-based compensation	9,139	8,605
Loss on non-marketable equity investments	2,181	158
Inventory write-downs	670	440
Deferred taxes	(7,514)	—
Change in fair value of contingent consideration	725	—
Other	388	209
Changes in operating assets and liabilities:		
Accounts receivable	(16,297)	(4,551)
Inventories	(3,948)	(6,827)
Prepaid expenses and other current and non-current assets	1,405	2,903
Accounts payable	625	293
Accrued expenses and other non-current liabilities	1,638	4,420
Net cash provided by operating activities	10,832	2,844
CASH FLOWS FROM INVESTING ACTIVITIES:		
Contributions to non-marketable investments	(868)	(5,074)
Purchase of marketable investments	(61,495)	(90,384)
Proceeds from sales of marketable investments	236	28,167
Proceeds from maturities of marketable investments	77,869	35,669
Purchases of property and equipment	(5,105)	(5,364)
Deposit payments for acquisition	—	(454)
Net cash provided by (used in) investing activities	10,637	(37,440)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock upon underwritten public offering, net of issuance cost	—	106,265
Proceeds from exercises of stock options	3,171	2,625
Proceeds from issuance of stock under employee stock purchase plan	3,584	2,914
Payment of employee taxes related to vested restricted stock	(13,845)	(9,190)
Payment of acquisition-related obligations	(4,431)	—
Other	(415)	—
Net cash (used in) provided by financing activities	(11,936)	102,614
Effect of foreign exchange rate changes on cash and cash equivalents	(465)	(2,859)
Net Increase in Cash and Cash Equivalents and Restricted Cash	9,068	65,159
CASH AND CASH EQUIVALENTS AND RESTRICTED CASH—Beginning of period	50,637	13,236
CASH AND CASH EQUIVALENTS AND RESTRICTED CASH—End of period	\$59,705	\$78,395
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Common shares issued as consideration in connection with a buyout agreement (Notes 6, 8 and 9)	\$5,256	\$—
Purchase of property and equipment funded through accounts payable and accrued liabilities	\$1,126	\$411

RECONCILIATION OF CASH AND CASH EQUIVALENTS AND RESTRICTED CASH:

Cash and cash equivalents	\$59,705	\$76,576
Restricted cash	\$—	\$1,819
Total cash and cash equivalent and restricted cash - End of period	\$59,705	\$78,395

See accompanying notes to the unaudited condensed consolidated financial statements

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Penumbra, Inc.

Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Organization and Description of Business

Penumbra, Inc. (the “Company”) is a global healthcare company focused on innovative therapies. The Company designs, develops, manufactures and markets medical devices and has a broad portfolio of products that addresses challenging medical conditions and significant clinical needs.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying condensed consolidated balance sheet as of June 30, 2018, the condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2018 and 2017, and the condensed consolidated statements of cash flows for the six months ended June 30, 2018 and 2017 are unaudited. The unaudited condensed consolidated financial statements included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and the applicable rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial information. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The condensed consolidated balance sheet as of December 31, 2017 was derived from the audited financial statements as of that date.

The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to state fairly the Company’s financial position as of June 30, 2018, the results of its operations for the three and six months ended June 30, 2018 and 2017, and the cash flows for the six months ended June 30, 2018 and 2017. The results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or for any other future annual or interim period. Certain changes in presentation were made in the condensed consolidated financial statements for the three and six months ended June 30, 2017 to conform to the presentation for the three and six months ended June 30, 2018, including the retrospective application of the Accounting Standards Update (“ASU”) 2016-18 as discussed further below.

The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2017, included in the Company’s Annual Report on Form 10-K. There have been no changes to the Company’s significant accounting policies during the six months ended June 30, 2018, as compared to the significant accounting policies described in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017, other than changes to the Company’s revenue policy described below in connection with the adoption of the guidance under the Accounting Standards Codification (“ASC”) 606.

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

Use of Estimates

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

Revenue Recognition

Revenue is comprised of product revenue net of returns, discounts, administration fees and sales rebates. The Company adopted the guidance under ASC 606 on January 1, 2018 using the modified retrospective method for all contracts not completed as of the date of adoption. Therefore, the comparative prior year information has not been adjusted and continues to be reported under ASC 605 with the impact of the adoption reflected in opening retained earnings. Under ASC 606, the Company recognizes revenue when control of the promised goods or services is transferred to our customers, in an amount that

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Penumbra, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

reflects the consideration we expect to be entitled to in exchange for those goods or services. Revenue from product sales continue to be recognized either on the date of shipment or the date of receipt by the customer, but is deferred for certain transactions when control has not yet transferred. However, with respect to products that the Company consigns to hospitals, which primarily consist of coils, the Company recognizes revenue at the time hospitals utilize products in a procedure.

Deferred revenue represents amounts that the Company has already invoiced its customers and that are ultimately expected to be recognized as revenue, but for which not all revenue recognition criteria have been met. As of June 30, 2018 and December 31, 2017, respectively, the Company's deferred revenue balance was not material.

Revenue is recorded at the net sales price, which includes estimates of variable consideration such as product returns utilizing historical return rates, rebates, discounts, and other adjustments to net revenue. To the extent the transaction price includes variable consideration, the Company estimates the amount of variable consideration that should be included in the transaction price. Variable consideration is included in revenue only to the extent that it is probable that a significant reversal of the revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

The Company's terms and conditions permit product returns and exchanges. The Company bases its estimates for sales returns on actual historical returns over the prior three years and they are recorded as reductions in revenue at the time of sale. Upon recognition, the Company reduces revenue and cost of revenue for the estimated return. Return rates can fluctuate over time, but are sufficiently predictable to allow the Company to estimate expected future product returns. For more information and disclosures on the Company's revenue, refer to Note "13. Revenues."

Segments

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

Recent Accounting Guidance

Recently Adopted Accounting Standards

In the first quarter of 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), and its associated amendments. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company applied the five step method outlined in the ASU to all revenue streams and elected to utilize the modified retrospective implementation method. The additional disclosures required by the ASU have been included in Note "13. Revenues."

In the first quarter of 2018, the Company adopted ASU No. 2016-18, Statement of Cash Flows: Restricted Cash, a consensus of the Financial Accounting Standards Board ("FASB") Emerging Issues Task Force. Under the standard, restricted cash and restricted cash equivalent amounts are presented within cash and cash equivalents when reconciling the total beginning and ending amounts shown on the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet is required. The impact of the adoption of ASU No. 2016-18 resulted in an increase in the ending cash and cash equivalents of \$1.8 million in the statement of cash flows for the six months ended June 30, 2017, with a corresponding \$1.7 million change in cash used in investing activities and the remaining change impacted the effect of foreign exchange rates on cash and cash equivalents.

In the first quarter of 2018, the Company adopted ASU No. 2017-09, Compensation - Stock Compensation - Scope of Modification Accounting. The standard provides clarification on when modification accounting should be used for

changes to the terms or conditions of a share-based payment award. This standard does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The standard is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The guidance was adopted on a prospective basis in the first quarter of 2018 and did not have any impact upon adoption.

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Penumbra, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

In the first quarter of 2018, the Company adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income. The standard allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the “Tax Reform Act”). The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. The Company elected to early adopt this standard on a prospective basis in the first quarter of 2018 and reclassify the stranded tax effects resulting from the Tax Reform Act from accumulated other comprehensive income to retained earnings. There were no additional income tax effects resulting from the Tax Reform Act reclassified from accumulated comprehensive income to retained earnings. The adoption did not have a material impact on the Company’s financial position.

In the first quarter of 2018, the Company adopted ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, which included amendments to expand income tax accounting and disclosure guidance pursuant to SEC Staff Accounting Bulletin No. 118 (“SAB 118”) issued by the SEC in December 2017. SAB 118 provides guidance on accounting for the income tax effects of the Tax Reform Act.

Refer to Note “11. Income Taxes” for more information and disclosures related to this amended guidance.

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, Leases, which amends the existing accounting standards for leases. In September 2017, the FASB issued ASU No. 2017-13 which provides additional clarification and implementation guidance on the previously issued ASU No. 2016-02. Under the new guidance, a lessee will be required to recognize a lease liability and right-of-use asset for all leases with terms in excess of twelve months. The new guidance also modifies the classification criteria and accounting for sales-type and direct financing leases, and requires additional disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. Consistent with current guidance, a lessee’s recognition, measurement, and presentation of expenses and cash flows arising from a lease will continue to depend primarily on its classification. In July 2018, the FASB issued ASU No. 2018-10 and ASU No. 2018-11, which further clarifies the application of the guidance issued under ASU No. 2016-02 and provides updates to transition methods and practical expedients. ASU No. 2018-11 provides an optional transition method in addition to the existing transition method which allows entities, at the adoption date, to recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. The accounting standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and must be applied using a modified retrospective approach. Early adoption is permitted. While the Company is continuing to assess all potential impacts of the standard, it expects that most of its lease commitments will be subject to the updated standard and recognized as lease liabilities and right-of-use assets upon adoption.

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

In June 2018, the FASB issued ASU No. 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting and reporting for share-based payments granted to nonemployees for goods and services. Under the new guidance, payments to nonemployees would be more closely aligned with the requirements for share-based payments granted to employees. The standard is effective for fiscal years and interim periods beginning after December 15, 2018. As the Company adopted ASC 606 in the first quarter of 2018, the Company is permitted to early adopt this standard. The Company does not anticipate the adoption of this standard to have a material impact on its financial statements.

3. Investments and Fair Value of Financial Instruments

Marketable Investments

The Company's marketable investments have been classified and accounted for as available-for-sale. The Company's marketable investments as of June 30, 2018 and December 31, 2017 were as follows (in thousands):

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Penumbra, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	\$13,707	\$ —	\$ (2)	\$13,705
U.S. treasury	6,401	—	(43)	6,358
U.S. agency and government sponsored securities	6,217	—	(35)	6,182
U.S. states and municipalities	11,465	—	(21)	11,444
Corporate bonds	109,985	31	(520)	109,496
Total	\$147,775	\$ 31	\$ (621)	\$147,185
	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	\$19,941	\$ —	\$ (8)	\$19,933
U.S. treasury	6,402	—	(28)	6,374
U.S. agency and government sponsored securities	4,787	—	(18)	4,769
U.S. states and municipalities	12,510	—	(23)	12,487
Corporate bonds	120,648	23	(280)	120,391
Total	\$164,288	\$ 23	\$ (357)	\$163,954

The following tables present the gross unrealized losses and the fair value for those marketable investments that were in an unrealized loss position for less than twelve months or for twelve months or longer as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018					
	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Commercial paper	\$9,717	\$ (2)	\$—	\$ —	\$9,717	\$ (2)
U.S. treasury	6,359	(43)	—	—	6,359	(43)
U.S. agency and government sponsored securities	4,183	(33)	1,998	(2)	6,181	(35)
U.S. states and municipalities	8,444	(21)	—	—	8,444	(21)
Corporate bonds	74,101	(395)	9,421	(125)	83,522	(520)
Total	\$102,804	\$ (494)	\$11,419	\$ (127)	\$114,223	\$ (621)
	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Commercial paper	\$19,933	\$ (8)	\$—	\$ —	\$19,933	\$ (8)
U.S. treasury	6,374	(28)	—	—	6,374	(28)
U.S. agency and government sponsored securities	2,778	(9)	1,991	(9)	4,769	(18)
U.S. states and municipalities	10,092	(23)	—	—	10,092	(23)
Corporate bonds	93,284	(188)	10,201	(92)	103,485	(280)
Total	\$132,461	\$ (256)	\$12,192	\$ (101)	\$144,653	\$ (357)

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Penumbra, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

The contractual maturities of the Company's marketable investments as of June 30, 2018 and December 31, 2017 were as follows (in thousands):

	June 30, 2018	December 31, 2017
	Fair Value	Fair Value
Due in less than one year	\$89,335	\$104,272
Due in one to five years	57,850	59,682
Total	\$147,185	\$163,954

Non-Marketable Equity Investments

During the second quarter of 2017, the Company and Sixense Enterprises, Inc. formed a privately-held company, MVI Health Inc. ("MVI"), with each party holding 50% of the issued and outstanding equity of MVI. Pursuant to agreements between the parties at the time of MVI's formation, the Company will be obligated to perform certain services or make additional cash contributions to MVI for no additional equity interest. These services include, but are not limited to, information technology, accounting, other administrative services and research and development. The Company's contributions are presented as a component of "Contributions to non-marketable investments" in the statement of cash flows.

The Company accounted for its investment under the equity method and is not required to consolidate MVI under the voting model. As of June 30, 2018, the Company determined that MVI was not a variable interest entity ("VIE"). The Company will reassess in subsequent periods whether MVI becomes a VIE due to changes in facts and circumstances, including changes to the sufficiency of the equity investment at risk, management and governance structure or capital structure.

As of June 30, 2018 and December 31, 2017, the carrying value of the non-marketable equity investment was approximately \$2.6 million and \$3.9 million, respectively, representing the Company's contributions to MVI offset by the Company's share of equity method investee losses. The non-marketable equity method investment is presented in long-term investments on the condensed consolidated balance sheet. During the three months ended June 30, 2018 and 2017, MVI had no revenue and recorded a net loss of \$2.5 million and \$0.3 million, respectively. During the six months ended June 30, 2018 and 2017, MVI had no revenue and recorded a net loss of \$4.4 million and \$0.3 million, respectively. The Company reflected its 50% share of MVI's losses in equity in losses of unconsolidated investees in the condensed consolidated statements of operations and comprehensive income (loss).

Fair Value of Financial Instruments

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

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

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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

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

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

Financial instruments classified within Level 2 of the fair value hierarchy are valued based on other observable inputs, including broker or dealer quotations or alternative pricing sources. When quoted prices in active markets for identical assets or

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

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

	As of June 30, 2018			
	Level 1	Level 2	Level 3	Fair Value
Financial Assets				
Cash equivalents:				
Commercial paper	\$—	\$27,656	\$—	\$27,656
Money market funds	1,725	—	—	1,725
Marketable investments:				
Commercial paper	—	13,705	—	13,705
U.S. treasury	6,358	—	—	6,358
U.S. agency and government sponsored securities	—	6,182	—	6,182
U.S. states and municipalities	—	11,444	—	11,444
Corporate bonds	—	109,496	—	109,496
Total	\$8,083	\$168,483	\$—	\$176,566
Financial Liabilities:				
Contingent consideration obligations ⁽¹⁾	\$—	—	14,181	14,181
Total	\$—	\$—	\$14,181	\$14,181
	As of December 31, 2017			
	Level 1	Level 2	Level 3	Fair Value
Financial Assets				
Cash equivalents:				
Commercial paper	\$—	\$9,185	\$—	\$9,185
Money market funds	2,264	—	—	2,264
Marketable investments:				
Commercial paper	—	19,933	—	19,933
U.S. treasury	6,374	—	—	6,374
U.S. agency and government sponsored securities	—	4,769	—	4,769
U.S. states and municipalities	—	12,487	—	12,487
Corporate bonds	—	120,391	—	120,391
Total	\$8,638	\$166,765	\$—	\$175,403
Financial Liabilities:				
Contingent consideration obligations ⁽¹⁾	—	—	17,392	17,392
Total	\$—	\$—	\$17,392	\$17,392

⁽¹⁾ More information on the contingent consideration obligations and the changes in fair value are presented below. As of June 30, 2018, the Company's contingent consideration liabilities are classified as Level 3 measurements for which fair value is derived from various inputs, including forecasted revenues during the earn-out and milestone periods, revenue volatilities, discount rates, and estimates in the timing and likelihood of achieving revenue-based

milestones. The fair value of the contingent consideration liability will be remeasured each reporting period.

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In addition to the revenue generated during the earn-out and milestone periods, the following table presents certain quantitative information about unobservable inputs used in the Level 3 fair value measurement of the Company's contingent consideration liabilities:

	Fair Value at June 30, 2018 (in thousands)	Valuation Method	Unobservable Inputs	Input (range where applicable)
Crossmed: Revenue-based milestones	\$ 2,400	Monte Carlo Simulation	Earn-out period over which revenue-based milestone payments are made Risk-adjusted discount rate Revenue volatilities for each type of revenue-based milestone	2018 - 2019 15% 8.9% and 14.8%
Technology Licensing Agreement: Revenue-based milestones	\$ 11,781	Income approach	Earn-out period over which revenue-based milestone payments are made Discount rate	2019 - 2021 2.6%

The following table summarizes the changes in fair value of the contingent consideration obligation for the six months ended June 30, 2018 (in thousands):

	Fair Value of Contingent Consideration		
	Crossmed Agreement ⁽¹⁾	Technology Licensing Agreement ⁽²⁾	Total
Balance at December 31, 2017	\$4,675	\$ 12,717	\$17,392
Payments of contingent consideration liabilities	(3,017)	—	(3,017)
Changes in fair value	725	(936)	(211)
Foreign currency remeasurement	17	—	17
Balance at June 30, 2018	\$2,400	\$ 11,781	\$14,181

⁽¹⁾ During the three and six months ended June 30, 2018, the fair value of the contingent consideration obligations related to the acquisition of Crossmed S.p.A. ("Crossmed") increased by \$0.3 million and \$0.7 million, respectively, which was recorded in sales, general and administrative expense in the condensed consolidated statements of operations and comprehensive income. The fair value of the contingent consideration increased as a result of updates to the underlying forecasts based on actual results to date and changes in estimates.

⁽²⁾ During the three and six months ended June 30, 2018, the fair value of the contingent consideration obligations related to the exclusive technology license agreement decreased by \$0.1 million and \$0.9 million, respectively, which resulted in a reduction in gross carrying amount of the related indefinite-lived intangible asset and the liability for the contingent consideration in the condensed consolidated balance sheets. The fair value of the contingent consideration decreased as a result of changes in the underlying revenue forecasts used to estimate the future milestone payments. For more information with respect to the nature of the Company's contingent consideration obligations, refer to Note "5. Business Combination" and Note "6. Intangible Assets," respectively.

During the three and six months ended June 30, 2018 and 2017, the Company did not record impairment charges related to its marketable investments and the Company did not hold any Level 3 marketable investments as of June 30, 2018 or December 31, 2017. Also, during the six months ended June 30, 2018 and 2017, the Company did not have any transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy. The Company did not have any financial

assets and liabilities measured at fair value on a non-recurring basis as of June 30, 2018 or December 31, 2017.

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4. Balance Sheet Components

Inventories

The following table shows the components of inventories as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, December 31,	
	2018	2017
Raw materials	\$14,009	\$ 13,529
Work in process	9,911	6,073
Finished goods	73,636	75,299
Inventories	\$97,556	\$ 94,901

Accrued Liabilities

The following table shows the components of accrued liabilities as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, December 31,	
	2018	2017
Payroll and employee-related cost	\$24,453	\$ 22,001
Sales return provision	3,009	3,035
Preclinical and clinical trial cost	864	1,514
Royalty	791	1,115
Product warranty	1,717	1,088
Leasehold improvement expenditures	918	1,012
Acquisition-related liabilities ⁽¹⁾	1,616	4,752
Other accrued liabilities	8,887	10,308
Total accrued liabilities	\$42,255	\$ 44,825

⁽¹⁾ Acquisition-related liabilities consists of contingent consideration related to the cash milestone payments and working capital adjustment liabilities for the acquisition of Crossmed. Refer to Note "5. Business Combination" for more information.

The following table shows the changes in the Company's estimated product warranty accrual, included in accrued liabilities, as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, December 31,	
	2018	2017
Balance at the beginning of the period	\$1,088	\$ 1,254
Accruals of warranties issued	889	471
Settlements of warranty claims	(260)	(637)
Balance at the end of the period	\$1,717	\$ 1,088

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Other Non-Current Liabilities

The following table shows the components of other non-current liabilities as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, December 31,	
	2018	2017
Deferred tax liabilities	\$3,249	\$ 3,299
Licensing-related cost ⁽¹⁾	11,781	12,717
Other non-current liabilities	1,968	2,462
Total other non-current liabilities	\$16,998	\$ 18,478

⁽¹⁾ Amount relates to the liability recorded for probable future milestone payments to be made under the licensing agreement described in Note “6. Intangible Assets.” Refer therein for more information.

5. Business Combination

On July 3, 2017 (the “Closing Date”), the Company completed the acquisition of Crossmed, a joint stock company organized under the laws of Italy. Crossmed is engaged in the business of distributing medical supplies and equipment in Italy, San Marino, the Vatican, and Switzerland. Crossmed was the Company’s exclusive distributor in Italy, San Marino and the Vatican and the acquisition provides the Company with a direct relationship with its customers in these regions. As of the Closing Date, Crossmed became a wholly-owned subsidiary of the Company and was integrated into the Company’s core business. The acquisition of Crossmed did not result in any changes to the Company’s operating or reportable segment structure and the Company continues to operate as one operating segment. The following table summarizes the Closing Date fair value of the consideration transferred, reflecting the measurement period adjustments recorded in the fourth quarter of 2017 (in thousands):

Cash, net of working capital and financial debt adjustments	\$11,088
Fair value of contingent consideration for milestone payments	4,343
Contract purchase price	\$15,431
Consideration for settlement of pre-existing receivable due from Crossmed to Penumbra	3,273
Total value of consideration transferred	\$18,704

On the Closing Date, the Company paid the sellers of Crossmed an initial payment of €8.2 million, or approximately \$9.4 million, subject to post-closing adjustments for working capital and financial debt. The Company is also obligated to pay additional consideration in the form of milestone payments based on Crossmed’s net revenue, and may be required to pay additional consideration based on incremental net revenue, for the year ended December 31, 2017, and each of the years ending December 31, 2018 and 2019. There is no limit on the milestone payments that can be paid out. During the six months ended June 30, 2018, the Company made \$4.4 million in cash payments to the Sellers, of which \$3.0 million related to the achievement of the 2017 milestones and the remainder related to working capital and financial debt adjustments. These payments have been presented as a component of financing activities in the consolidated statement of cash flows due to the nature and timing of the payments.

As of June 30, 2018, the fair value of the current and non-current portion of the related liabilities for the future cash milestone payments recorded on the condensed consolidated balance sheet was \$1.2 million and \$1.2 million, respectively. For more information with respect to the nature and fair value of the Company’s contingent consideration obligations, refer to Note “3. Investments and Fair Value of Financial Instruments.”

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The purchase price measurement period was closed as of June 30, 2018. The following table presents the allocation of the purchase price for Crossmed, reflecting the measurement period adjustments recorded in 2017 (in thousands):

	Acquisition-Date Fair Value	Estimated Useful Life of Finite-Lived Intangible Assets
Tangible assets acquired and (liabilities) assumed:		
Accounts receivable	\$ 4,406	
Inventories	1,343	
Other current and non-current assets	1,596	
Property and equipment, net	829	
Accounts payable	(740))
Accrued liabilities and obligations for short-term debt and credit facilities	(1,868))
Deferred tax liabilities	(2,472))
Other non-current liabilities	(797))
Intangible assets acquired:		
Customer relationships	\$ 6,790	15 years
Other	1,750	5 years
Goodwill	7,867	
Total purchase price	\$ 18,704	

Acquired intangible assets are classified as Level 3 measurements for which fair value is derived from valuations based on inputs that are unobservable and significant to the overall fair value measurement. The Company used the income approach, specifically the discounted cash flow method and the incremental cash flow approach, to derive the fair value of the customer relationships and other intangible assets. Customer relationships are direct relationships with physicians and hospitals performing procedures with the distributed products. Other intangibles consist of non-Penumbra supplier relationships and sub-distributor relationships with third parties used to sell products, both as of the Closing Date. The intangible assets are amortized on a straight-line basis over their assigned estimated useful lives. The amortization of the acquired intangible assets are not deductible for tax purposes. As a result, a \$2.5 million deferred tax liability was recorded as of the Closing Date.

The goodwill arising from the Crossmed acquisition is primarily attributed to expected synergies from future growth and assembled workforce. Goodwill will not be deductible for tax purposes.

6. Intangible Assets

Acquired Intangible Assets

The following table presents details of the Company's acquired finite-lived and indefinite-lived intangible assets, as of June 30, 2018 and December 31, 2017 (in thousands, except weighted-average amortization period):

As of June 30, 2018	Weighted-Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	15.0 years	\$ 6,966	\$ (465)) \$ 6,501
Trade secrets and processes	20.0 years	5,256	(131)) 5,125
Other	5.0 years	1,796	(359)) 1,437
Total intangible assets subject to amortization	15.9 years	\$ 14,018	\$ (955)) \$ 13,063
Intangible assets related to licensed technology		14,281	—	14,281
Total intangible assets		\$ 28,299	\$ (955)) \$ 27,344

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As of December 31, 2017	Weighted-Average Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	15.0 years	\$ 7,141	\$ (238)	\$ 6,903
Other	5.0 years	1,841	(183)	1,658
Total intangible assets subject to amortization	13.1 years	\$ 8,982	\$ (421)	\$ 8,561
Intangible assets related to licensed technology		15,217	—	15,217
Total intangible assets		\$ 24,199	\$ (421)	\$ 23,778

The customer relationships and other intangible assets subject to amortization relate to the acquisition of Crossmed during the third quarter of 2017. The gross carrying amount and accumulated amortization of these intangible assets are subject to foreign currency translation effects. Refer to Note “5. Business Combination” for more information. The Company’s \$5.3 million trade secrets and processes intangible asset was recognized in connection with a royalty buyout agreement during the first quarter of 2018, which is discussed further in Note “8. Commitments and Contingencies” and Note “9. Stockholders’ Equity.”

The following table presents the amortization recorded related to the Company’s finite-lived intangible assets (in thousands):

	Three Months Ended June 30, 2018	2017	Six Months Ended June 30, 2018	2017
Cost of revenue	\$ 101	\$ —	-\$ 131	\$ —
Sales, general and administrative	210	—	427	—
Total	\$ 311	\$ —	-\$ 558	\$ —

Licensed technology

During the third quarter of 2017, the Company entered into an exclusive technology license agreement (the “License Agreement”) that required the Company to pay an upfront payment to the licensor of \$2.5 million and future revenue milestone-based payments on sales of products covered by the licensed intellectual property. The Company recorded an intangible asset equal to the total payments made and expected to be made under the License Agreement and a corresponding contingent consideration liability for the future milestone payments not yet paid. The licensed technology is accounted for as an indefinite-lived intangible asset. Once regulatory approval is received to market and commercialize products utilizing the underlying technology, the Company will begin amortizing the intangible asset. The fair value of the contingent consideration liability is evaluated at the end of each reporting period. Prior to the commercialization of products utilizing the underlying technology, any changes in fair value of the contingent consideration liability are recorded as an adjustment between the liability balance and the gross carrying amount of the indefinite-lived intangible asset. As of June 30, 2018, the balance of the contingent consideration liability related to probable future milestone payments under the Licensing Agreement was \$11.8 million and is included in other non-current liabilities on the condensed consolidated balance sheet. As of June 30, 2018, the gross carrying amount of the indefinite-lived intangible asset was \$14.3 million. Refer to Note “3. Investments and Fair Value of Financial Instruments” for more information. During the six months ended June 30, 2018, the Company noted no events or circumstances that indicate the carrying value of the licensed technology may no longer be recoverable and that an impairment loss may have occurred.

7. Goodwill

The following table presents the changes in goodwill during the six months ended June 30, 2018 (in thousands):

Total
Company

Balance as of December 31, 2017	\$ 8,178
Foreign currency translation	(201)
Balance as of June 30, 2018	\$ 7,977

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Goodwill Impairment Review

The Company reviews goodwill for impairment annually during the fourth quarter, on October 31st, or more frequently if events or circumstances indicate that an impairment loss may have occurred. During the six months ended June 30, 2018, there were no events or changes in circumstances which triggered an impairment review.

8. Commitments and Contingencies

Lease Commitments

The Company leases its offices primarily under non-cancelable operating leases that expire at various dates through 2031, subject to its option to renew certain leases for an additional 5 to 15 years. Rent expense for non-cancelable operating leases with scheduled rent increases is recognized on a straight-line basis over the lease term. Rent expense for the three months ended June 30, 2018 and 2017 was \$1.4 million and \$1.5 million, respectively, and for the six months ended June 30, 2018 and 2017 was \$2.9 million and \$2.9 million, respectively. In addition, the Company's lease commitments also require it to make additional payments during the lease term for taxes, insurance and other operating expenses. The Company leases other equipment and vehicles primarily under non-cancelable operating leases that expire at various dates through 2021.

Royalty Obligations

In March 2005, the Company entered into a license agreement that requires the Company to make minimum royalty payments to the licensor on a quarterly basis. As of both June 30, 2018 and December 31, 2017, the license agreement required minimum annual royalty payments of \$0.1 million in equal quarterly installments. On each January 1, the quarterly calendar year minimum royalty shall be adjusted to equal the prior year's minimum royalty adjusted by a percentage equal to the percentage change in the "consumer price index for all urban consumers" for the prior calendar year as reported by the U.S. Department of Labor. Unless terminated earlier, the term of the license agreement shall continue until the expiration of the last to expire patent that covers that licensed product or for the period of 15 years following the first commercial sale of such licensed product, whichever is longer. The first commercial sale of covered products occurred in June 2007.

In April 2012, the Company entered into an agreement that requires the Company to pay, on a quarterly basis, a 5% royalty on sales of products covered under applicable patents. The first commercial sale of covered products occurred in April 2014. Unless terminated earlier, the royalty term for each applicable product shall continue for 15 years following the first commercial sale of such patented product, or when the applicable patent covering such product has expired, whichever is sooner.

In November 2013, the Company entered into an agreement that required the Company to pay, on a quarterly basis, a 3% royalty on the first \$5.0 million in sales and a 1% royalty on sales thereafter of products covered under applicable patents. The agreement was terminated effective January 1, 2018.

In April 2015, the Company entered into a royalty agreement that required the Company to pay a 2% royalty on sales of certain products covered by the agreement, on a quarterly basis, in exchange for certain trade secrets and processes which were used to develop such covered products. The Company began the first commercial sale of the covered products in July 2015. In the first quarter of 2018, the Company entered into a buyout of this agreement (the "Buyout Agreement") in which future royalty payments were canceled in exchange for shares of the Company's common stock with a fair value of \$5.3 million. The Company recorded an intangible asset equal to the \$5.3 million buyout amount which will be amortized into cost of sales over the period in which the Company receives future economic benefit. After determining that the pattern of future cash flows associated with this intangible asset could not be reliably estimated with a high level of precision, the Company concluded that the intangible asset will be amortized on a straight line basis over its estimated useful life. For more information refer to Note "6. Intangible Assets" and Note "9. Stockholders' Equity."

Royalty expense included in cost of revenue for the three months ended June 30, 2018 and 2017, was \$0.8 million and \$1.2 million, respectively, and for the six months ended June 30, 2018 and 2017 was \$1.6 million and \$2.0 million, respectively.

Contingencies

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of business. The Company accrues a liability for such matters when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. Refer to Note “3. Investments and Fair Value of Financial Instruments,” Note “5. Business Combination” and Note “6. Intangible Assets” for more information on contingent liabilities recorded on the condensed consolidated balance sheet.

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Indemnification

The Company enters into standard indemnification arrangements in the ordinary course of business. In many such arrangements, the Company agrees to indemnify, hold harmless, and reimburse the indemnified parties for losses suffered or incurred by the indemnified parties in connection with any trade secret, copyright, patent or other intellectual property infringement claim by any third-party with respect to the Company's technology. The Company also agrees to indemnify many purchasers for product defect and similar claims. The term of these indemnification agreements is generally perpetual. The maximum potential amount of future payments the Company could be required to make under these agreements is not determinable because it involves claims that may be made against the Company in the future, but have not yet been made.

The Company has entered into indemnification agreements with its directors and officers that may require the Company to indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of the individual.

The Company has not incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

No liability associated with any of these indemnification requirements has been recorded to date.

Litigation

From time to time, the Company is subject to other claims and assessments in the ordinary course of business. The Company is not currently a party to any such litigation matter that, individually or in the aggregate, is expected to have a material adverse effect on the Company's business, financial condition, results of operations or cash flows.

9. Stockholders' Equity

Common Stock

In the first quarter of 2017, the Company issued and sold an aggregate of 1,495,000 shares of common stock at a public offering price of \$76.00 per share, less the underwriters' discounts and commissions, pursuant to an underwritten public offering. The Company received approximately \$106.3 million in net cash proceeds after deducting underwriting discounts and commissions of \$6.8 million and other offering expenses of \$0.5 million.

In the first quarter of 2018, the Company issued 53,256 fully vested restricted stock units with a fair value of \$5.3 million in connection with the Buyout Agreement, as discussed in Note "6. Intangible Assets" and Note "8.

Commitments and Contingencies." The Company recorded the \$5.3 million fair value of the shares issued to additional-paid in capital on the condensed consolidated balance sheet upon the issuance of the awards, with the associated expense being amortized into cost of sales over the period in which the Company receives future economic benefit from the buyout.

Equity Incentive Plans

Stock Options

Activity of stock options under the Penumbra, Inc. 2005 Stock Plan, the Penumbra, Inc. 2011 Equity Incentive Plan and the Amended and Restated Penumbra, Inc. 2014 Equity Incentive Plan (collectively the "Plans") during the six months ended June 30, 2018 is set forth below:

	Number of Shares	Weighted-Average Exercise Price
Balance at December 31, 2017	2,107,104	\$ 17.58
Exercised	(244,166)	12.97
Canceled/Forfeited	(2,014)	22.04
Balance at June 30, 2018	1,860,924	18.18

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Restricted Stock and Restricted Stock Units

Activity of unvested restricted stock and restricted stock units under the Plans during the six months ended June 30, 2018 is set forth below:

	Number of Shares	Weighted -Average Grant Date Fair Value
Unvested at December 31, 2017	742,405	\$ 38.86
Granted	89,436	103.09
Vested	(330,374)	33.57
Canceled/Forfeited	(3,125)	77.14
Unvested at June 30, 2018	498,342	53.65

As of June 30, 2018, 486,889 restricted stock and restricted stock units are expected to vest.

Stock-based Compensation

The following table sets forth the stock-based compensation expense included in the Company's condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of revenue	\$198	\$191	\$417	\$501
Research and development	375	308	743	561
Sales, general and administrative	4,412	4,094	7,979	7,543
Total	\$4,985	\$4,593	\$9,139	\$8,605

As of June 30, 2018, total unrecognized compensation cost was \$25.5 million related to unvested share-based compensation arrangements which is expected to be recognized over a weighted average period of 2.1 years.

The total stock-based compensation cost capitalized in inventory was \$0.3 million and \$0.2 million as of June 30, 2018 and December 31, 2017, respectively.

10. Accumulated Other Comprehensive Income (Loss)

Other comprehensive income (loss) consists of two components: unrealized gains or losses on the Company's available-for-sale marketable investments and gains or losses from foreign currency translation adjustments. Until realized and reported as a component of net income (loss), these comprehensive income (loss) items accumulate and are included within accumulated other comprehensive income (loss). Unrealized gains and losses on the Company's marketable investments are reclassified from accumulated other comprehensive income (loss) into earnings when realized upon sale, and are determined based on specific identification of securities sold. Gains and losses from the translation of assets and liabilities denominated in non-U.S. dollar functional currencies are included in accumulated other comprehensive income (loss).

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The following table summarizes the changes in the accumulated balances during the three and six months ended June 30, 2018 and June 30, 2017, and includes information regarding the manner in which the reclassifications out of accumulated other comprehensive income (loss) into earnings affect the Company's condensed consolidated statements of operations and comprehensive income (loss) (in thousands):

	Three Months Ended June 30, 2018			Three Months Ended June 30, 2017		
	Marketable Investments	Currency Translation Adjustments	Total	Marketable Investments	Currency Translation Adjustments	Total
Balance at beginning of the period	\$(553)	\$ 3,190	\$2,637	\$(35)	\$(3,891)	\$(3,926)
Other comprehensive income before reclassifications:						
Unrealized gain— marketable investments	132	—	132	2	—	2
Foreign currency translation (losses)	—	(3,400)	(3,400)	—	(766)	(766)
Income tax effect — (expense)	(30)	—	(30)	—	—	—
Net of tax	102	(3,400)	(3,298)	2	(766)	(764)
Amounts reclassified from accumulated other comprehensive income to earnings:						
Realized gains — marketable investments	—	—	—	(5)	—	(5)
Income tax effect — (expense)	—	—	—	—	—	—
Net of tax	—	—	—	(5)	—	(5)
Net current-year other comprehensive income (loss)	102	(3,400)	(3,298)	(3)	(766)	(769)
Balance at end of the period	\$(451)	\$(210)	\$(661)	\$(38)	\$(4,657)	\$(4,695)
	Six Months Ended June 30, 2018			Six Months Ended June 30, 2017		
	Marketable Investments	Currency Translation Adjustments	Total	Marketable Investments	Currency Translation Adjustments	Total
Balance at beginning of the period	\$(235)	\$ 1,804	\$1,569	\$(105)	\$(4,583)	\$(4,688)
Other comprehensive income before reclassifications:						
Unrealized (losses) gain— marketable investments	(253)	—	(253)	103	—	103
Foreign currency translation (losses)	—	(1,792)	(1,792)	—	(74)	(74)
Income tax effect — benefit (expense)	37	(222)	(185)	—	—	—
Net of tax	(216)	(2,014)	(2,230)	103	(74)	29
Amounts reclassified from accumulated other comprehensive income to earnings:						
Realized gains — marketable investments	—	—	—	(36)	—	(36)
Income tax effect — expense	—	—	—	—	—	—
Net of tax	—	—	—	(36)	—	(36)
Net current-year other comprehensive (loss) income	(216)	(2,014)	(2,230)	67	(74)	(7)
Balance at end of the period	\$(451)	\$(210)	\$(661)	\$(38)	\$(4,657)	\$(4,695)

11. Income Taxes

The Company's income tax expense, deferred tax assets and liabilities, and reserves for unrecognized tax benefits reflect management's best assessment of estimated current and future taxes to be paid. The Company is subject to income taxes in both the United States and foreign jurisdictions. Significant judgment and estimates are required in determining the consolidated income tax expense.

During interim periods, the Company generally utilizes the estimated annual effective tax rate method which involves the use of forecasted information. Under this method, the provision is calculated by applying an estimate of the annual effective tax rate for the full fiscal year to “ordinary” income or loss (pretax income or loss excluding unusual or infrequently occurring discrete items) for the reporting period. Jurisdictions with tax assets for which the Company believes a tax benefit cannot be realized are excluded from the computation of its annual effective tax rate.

The Company’s provision for income taxes was a \$4.9 million tax benefit for the three months ended June 30, 2018, compared to a \$0.5 million tax expense for the three months ended June 30, 2017. The Company’s effective tax rate changed to

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(51.2)% for the three months ended June 30, 2018, compared to (52.5)% for the three months ended June 30, 2017. The Company's provision for income taxes was a \$6.9 million tax benefit in the six months ended June 30, 2018, compared to a \$1.8 million tax expense in the six months ended June 30, 2017. The Company's effective tax rate changed to (48.6)% for the six months ended June 30, 2018, compared to (68.8)% for the six months ended June 30, 2017. The tax benefit from income taxes for the three and six months ended June 30, 2018 was primarily due to the inclusion of excess tax benefits from stock-based compensation attributable to the Company's US jurisdiction, offset by income taxes attributable to the Company's worldwide profits. The tax provision for the three and six months ended June 30, 2017 was primarily due to income taxes attributable to the Company's foreign jurisdictions, and the tax impact from recognizing the deferred tax assets associated with intra-entity asset transfers. The tax benefits attributable to the Company's US jurisdiction were excluded from its tax provision for the three and six months ended June 30, 2017 due to the partial valuation allowance recorded against the Company's domestic DTAs as of June 30, 2017.

On December 22, 2017, the Tax Reform Act was enacted. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, including but not limited to, lowering the U.S. corporate income tax rate to 21% effective January 1, 2018, implementing a territorial tax system, imposing a one-time transition tax on previously untaxed accumulated earnings and profits of foreign subsidiaries, and creating new taxes on foreign sourced earnings. Also on December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin 118 ("SAB 118"), which provides guidance on accounting for tax effects of the Tax Reform Act. SAB 118 provides a measurement period, that should not extend beyond one year from the Tax Reform Act enactment date, for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Reform Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Reform Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate to be included in the financial statements. In the six months ended June 30, 2018, the Company recorded a provisional tax charge for the deemed repatriation tax on the undistributed earnings of its foreign subsidiaries. The Company also made sufficient progress on its global intangible low-taxed income tax analysis to reasonably estimate the effects, and therefore reflected provisional amounts in the Company's financial statements for the six months ended June 30, 2018. Recording estimates of the tax impact of the deemed repatriation and the global intangible low-taxed income did not have a material effect on the Company's financial statements. The final impact of the Tax Reform Act may differ from these estimates, due to, among other things, changes in the Company's interpretations and assumptions, and additional guidance that may be issued.

With the adoption of ASU 2016-09, additional deferred tax assets ("DTAs") of NOL and credit carryforwards were created. With any DTAs, an assessment is necessary to determine if sufficient taxable income will be generated to realize the DTAs and, if not, a substantial valuation allowance to reduce the DTAs may be required. The Company assessed its ability to realize the benefits of its domestic DTAs by evaluating all available positive and negative evidence, objective and subjective in nature, including (1) cumulative results of operations in recent years, (2) sources of recent pre-tax income, (3) estimates of future taxable income, and (4) the length of net operating loss ("NOL") carryforward periods.

The Company considered its projections of future taxable income in conjunction with relevant provisions of the Tax Reform Act, and concluded that sufficient future taxable income will be generated to realize the benefits of its federal DTAs prior to expiration other than its federal research and development tax credit DTAs. The Company's federal research and development tax credit DTAs, which have a 20 year carryforward period, are expected to expire prior to utilization based on future projected taxable income. As a result, the Company maintains a valuation allowance against its federal research and development tax credit DTAs as of June 30, 2018.

Consistent with prior periods, the Company maintained a full valuation allowance against its California DTAs as of June 30, 2018.

12. Net Income (Loss) per Share

The Company's basic net income (loss) per share is calculated by dividing the net income (loss) by the weighted average number of shares of common stock outstanding for the period. The diluted net income (loss) per share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of this calculation, options to purchase common stock, restricted stock, restricted stock units and stock sold through the Company's employee stock purchase plan are considered common stock equivalents.

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A reconciliation of the numerator and denominator used in the calculation of the basic and diluted income (loss) per share for the three and six months ended June 30, 2018 and 2017 is as follows (in thousands, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss) — basic and diluted	\$ 13,381	\$ (1,558)	\$ 18,872	\$ (4,664)
Denominator:				
Weighted average shares used to compute net income (loss):				
Basic	34,072,223	33,219,487	33,959,997	32,420,105
Effect of dilutive securities from stock-based benefit plans, as calculated using treasury stock method	2,044,031	—	2,070,307	—
Diluted	36,116,254	33,219,487	36,030,304	32,420,105
Net income (loss) per share from:				
Basic	\$0.39	\$ (0.05)	\$0.56	\$ (0.14)
Diluted	\$0.37	\$ (0.05)	\$0.52	\$ (0.14)

Outstanding common stock equivalents of 8 thousand and 3.2 million shares for the three months ended June 30, 2018 and 2017, respectively, and 63 thousand and 3.2 million shares for the six months ended June 30, 2018 and 2017, respectively, were excluded from the computation of diluted net income (loss) per share because their effect would have been anti-dilutive.

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13. Revenues

Adoption of ASC Topic 606, "Revenue from Contracts with Customers"

The Company adopted the guidance under ASC 606 on January 1, 2018 using the modified retrospective method for all contracts not completed as of the date of adoption. Therefore, the comparative prior year information has not been adjusted and continues to be reported under ASC 605 with the impact of the adoption reflected in opening retained earnings. As a result of adoption, the cumulative impact to our retained earnings at January 1, 2018 was \$0.3 million. The adoption of ASC 606 represents a change in accounting principle that more closely aligns the timing of revenue recognition with the point in time that a performance obligation is satisfied. The Company's performance obligations are satisfied at a point in time. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue from prior periods, however additional disclosures have been added in accordance with the guidance.

As required by ASC 606, the impact of adoption of the new revenue standard on the Company's condensed consolidated statements of operations and comprehensive income and condensed consolidated balance sheets was as follows (in thousands):

	As of June 30, 2018			Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	As Reported	Adjustments	Adjusted Balance Without 606 Adoption	As Reported	Adjustments	Adjusted Balance Without 606 Adoption	As Reported	Adjustments	Adjusted Balance Without 606 Adoption
Consolidated Balance Sheet Data:									
Assets									
Accounts receivable, net of doubtful accounts	74,059	(898)	73,161	74,059	(898)	73,161	212,339	(240)	212,099
Inventories	97,556	305	97,861	97,556	305	97,861	73,530	(88)	73,442
Deferred taxes	34,129	187	34,316	34,129	187	34,316	13,328	(152)	13,176
Equity									
Retained Earnings	21,333	(406)	20,927	21,333	(406)	20,927	14,167	(152)	14,015
Consolidated Income Statement Data:									
Revenue	109,638	(118)	109,520	109,638	(118)	109,520	212,339	(240)	212,099
Cost of revenue	37,386	(30)	37,356	37,386	(30)	37,356	73,530	(88)	73,442
Income (loss) from operations	9,283	(88)	9,195	9,283	(88)	9,195	13,328	(152)	13,176
Income (loss) before income taxes and equity in losses of unconsolidated investee	9,663	(88)	9,575	9,663	(88)	9,575	14,167	(152)	14,015
(Benefit from) provision for income taxes	(4,948)	(28)	(4,976)	(4,948)	(28)	(4,976)	(6,886)	(48)	(6,934)
Net income (loss)	13,381	(60)	13,321	13,381	(60)	13,321	18,872	(104)	18,768

Revenue Recognition

Revenue is recognized in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. All revenue recognized in the income statement is considered to be revenue from contracts with customers.

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The Company's revenues disaggregated by geography, based on the destination to which the Company ships its products, for the three and six months ended June 30, 2018 and 2017 was as follows (in thousands):

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
United States	\$71,279	\$53,420	\$137,080	\$101,907
Japan	10,614	8,342	21,296	15,984
Other International	27,745	18,827	53,963	35,911
Total	\$109,638	\$80,589	\$212,339	\$153,802

The Company's revenues disaggregated by product category, for the three and six months ended June 30, 2018 and 2017 was as follows (in thousands):

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Neuro	\$74,196	\$56,203	\$145,624	\$