

CUTERA INC
Form 10-Q
May 09, 2018

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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, 2018

OR

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

For the transition period _____ to_____.

Commission file number: 000-50644

Cutera, Inc.

(Exact name of registrant as specified in its charter)

Delaware **77-0492262**
(State or other jurisdiction of incorporation or organization) (I.R.S. employer identification no.)

3240 Bayshore Blvd., Brisbane, California 94005

(Address of principal executive offices)

(415) 657-5500

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See 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	Smaller reporting company	Emerging growth company
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of Registrant's common stock issued and outstanding as of April 30, 2018, was 13,634,482

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CUTERA, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

(unaudited)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$10,910	\$14,184
Marketable investments	13,062	21,728
Accounts receivable, net	19,862	20,777
Inventories	30,979	28,782
Other current assets and prepaid expenses	2,601	2,903
Total current assets	77,414	88,374
Property and equipment, net	2,214	2,096
Deferred tax asset	21,792	19,055
Goodwill	1,339	1,339
Other long-term assets	5,367	374
Total assets	\$108,126	\$111,238
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$8,206	\$7,002
Accrued liabilities	20,083	26,848
Deferred revenue	8,847	9,461
Total current liabilities	37,136	43,311
Deferred revenue, net of current portion	2,168	2,195
Income tax liability	384	379

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Other long-term liabilities	583	460
Total liabilities	40,271	46,345

Commitments and Contingencies (Note 12)

Stockholders' equity:

Convertible preferred stock, \$0.001 par value; authorized: 5,000,000 shares; none issued and outstanding	—	—
Common stock, \$0.001 par value; authorized: 50,000,000 shares; issued and outstanding: 13,634,154 and 13,477,973 shares at March 31, 2018 and December 31, 2017, respectively	14	13
Additional paid-in capital	62,057	62,025
Retained earnings	5,888	2,947
Accumulated other comprehensive loss	(104)	(92)
Total stockholders' equity	67,855	64,893

Total liabilities and stockholders' equity	\$108,126	\$ 111,238
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The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31, 2018 2017	
Net revenue:		
Products	\$29,264	\$24,475
Service	4,861	4,824
Total net revenue	34,125	29,299
Cost of revenue:		
Products	13,922	11,144
Service	2,869	2,634
Total cost of revenue	16,791	13,778
Gross profit	17,334	15,521
Operating expenses:		
Sales and marketing	13,088	10,773
Research and development	3,556	2,945
General and administrative	5,439	3,216
Total operating expenses	22,083	16,934
Loss from operations	(4,749)	(1,413)
Interest and other income, net	98	273
Loss before income taxes	(4,651)	(1,140)
Benefit for income taxes	(2,619)	(118)
Net loss	\$(2,032)	\$(1,022)
Net loss per share:		
Basic and Diluted	\$(0.15)	\$(0.07)
Weighted-average number of shares used in per share calculations:		
Basic and Diluted	13,587	13,840

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

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CUTERA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended March 31,	
	2018	2017
Net loss	\$(2,032)	\$(1,022)
Other comprehensive loss:		
Available-for-sale investments		
Net change in unrealized gain (loss) on available-for-sale investments	(21)	3
Less: Reclassification adjustment for (gains) losses on investments recognized during the period	9	(4)
Net change in unrealized loss on available-for-sale investments	(12)	(1)
Tax loss (benefit)	—	—
Other comprehensive loss, net of tax	(12)	(1)
Comprehensive loss	\$(2,044)	\$(1,023)

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

Table of Contents**CUTERA, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(2,032)	\$(1,022)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	1,688	1,395
Depreciation of tangible assets	254	248
Amortization of contract acquisition costs	373	—
Change in deferred tax asset	(2,737)	(17)
Other	25	(34)
Changes in assets and liabilities:		
Accounts receivable	915	(1,305)
Inventories	(2,197)	(695)
Other current assets and prepaid expenses	1,753	(158)
Other long-term assets	(2,150)	(9)
Accounts payable	1,204	491
Accrued liabilities	(6,727)	(2,657)
Deferred revenue	(456)	(23)
Other long-term liabilities	40	1
Net cash used in operating activities	(10,047)	(3,785)
Cash flows from investing activities:		
Acquisition of property, equipment and software	(104)	(69)
Disposal of property and equipment	—	25
Proceeds from sales of marketable investments	13,044	5,255
Proceeds from maturities of marketable investments	—	14,035
Purchase of marketable investments	(4,390)	(15,972)
Net cash provided by investing activities	8,550	3,274
Cash flows from financing activities:		
Repurchase of common stock	—	(2,700)
Proceeds from exercise of stock options and employee stock purchase plan	633	1,751
Taxes paid related to net share settlement of equity awards	(2,288)	(784)
Payments on capital lease obligations	(122)	(88)

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Net cash used in financing activities	(1,777)	(1,821)
Net decrease in cash and cash equivalents	(3,274)	(2,332)
Cash and cash equivalents at beginning of period	14,184	13,775
Cash and cash equivalents at end of period	\$10,910	\$11,443

Supplemental disclosure of non-cash items:

Repurchase of common stock acquired but not settled	—	\$207
Assets acquired under capital lease	\$284	\$80

The accompanying notes are an integral part of these unaudited Condensed Consolidated Financial Statements.

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CUTERA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Description of Operations and Principles of Consolidation

Cutera, Inc. (“Cutera” or the “Company”) is a global provider of laser and other energy-based aesthetic systems for practitioners worldwide. The Company designs, develops, manufactures, and markets laser and other energy-based product platforms for use by physicians and other qualified practitioners which enable them to offer safe and effective aesthetic treatments to their customers. The Company currently markets the following key system platforms: *excel V*, *excel HR*, *enlighten*, *Juliet*, *Secret RF*, *truSculpt* and *xeo*. The Company’s systems offer multiple hand pieces and applications, which allow customers to upgrade their systems. The sales of (i) systems, system upgrades and hand pieces (classified as “Systems” revenue); (ii) hand piece refills applicable to *Titan* and *truSculpt 3D*, as well as single use disposable tips applicable to *Juliet*, *Secret RF* (classified as “Consumables”); and (iii) the distribution of *third* party manufactured skincare products (classified as “Skincare” revenue); and collectively classified as “Products” revenue. In addition to Products revenue, the Company generates revenue from the sale of post-warranty service contracts, parts, detachable hand piece replacements (except for *Titan* and *truSculpt 3D*) and service labor for the repair and maintenance of products that are out of warranty, all of which is classified as “Service” revenue.

Headquartered in Brisbane, California, the Company has wholly-owned subsidiaries that are currently operational in Australia, Belgium, Canada, France, Germany, Hong Kong, Japan, Spain, Switzerland and the United Kingdom. These subsidiaries market, sell and service the Company’s products outside of the United States.

Unaudited Interim Financial Information

In the opinion of the Company, the accompanying unaudited Condensed Consolidated Financial Statements included in this report reflect all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of its financial position as of *March 31, 2018*, its results of operations for the *three* months period ended *March 31, 2018*, and *2017*, comprehensive loss for the *three* months period ended *March 31, 2018* and *2017*, and cash flows for the *three* months ended *March 31, 2018*, and *2017*. The *December 31, 2017* Condensed Consolidated Balance Sheet was derived from audited financial statements, but does *not* include all disclosures required by generally accepted accounting principles in the United States of America (“GAAP”). The results for interim periods are *not* necessarily indicative of the results for the entire year or any other interim period. The accompanying condensed consolidated

financial statements should be read in conjunction with the Company's previously filed audited financial statements and the related notes thereto included in the Company's annual report on Form 10-K for the year ended *December 31, 2017* filed with the Securities and Exchange Commission (the "SEC") on *March 26, 2018*.

Use of Estimates

The preparation of interim Condensed Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the accompanying notes, and the reported amounts of revenue and expenses during the reported periods. Actual results could differ materially from those estimates.

On an ongoing basis, the Company evaluates their estimates, including those related to warranty obligation, sales commission, accounts receivable and sales allowances, valuation of inventories, fair values of goodwill, useful lives of property and equipment, assumptions regarding variables used in calculating the fair value of the Company's equity awards, expected achievement of performance based vesting criteria, fair value of investments, the standalone selling price of the Company's products and services, the customer life and period of benefit used to capitalize and amortize contracts acquisition costs, variable consideration, contingent liabilities, recoverability of deferred tax assets, and effective income tax rates, among others. Management bases their estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Risks and Uncertainties

The Company's future results of operations involve a number of risks and uncertainties. Factors that could affect the Company's future operating results and cause actual results to vary materially from expectations include, but are *not* limited to, rapid technological change, continued acceptance of the Company's products, stability of world financial markets, management of international activities, competition from substitute products and larger companies, ability to obtain regulatory approval, government regulations, patent and other litigations, ability to protect proprietary technology from counterfeit versions of the Company's products, strategic relationships and dependence on key individuals. If the Company fails to adhere to ongoing Food and Drug Administration (the "FDA") Quality System Regulation, the FDA *may* withdraw its market clearance or take other action. The Company's manufacturers and suppliers *may* encounter supply interruptions or problems during manufacturing due to a variety of reasons, including failure to comply with applicable regulations, including the FDA's Quality System Regulation, equipment malfunction and environmental factors, any of which could delay or impede the Company's ability to meet demand.

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Comparability

The Company adopted the new revenue standard effective *January 1, 2018*, using the modified retrospective method. Prior period financial statements were *not* retrospectively restated. The consolidated balance sheet as of *December 31, 2017* and results of operations for the *three* months ended *March 31, 2017* were prepared using accounting standards that were different than those in effect for the *three* months ended *March 31, 2018*. As a result the consolidated balance sheets as of *March 31, 2018* and *December 31, 2017* are *not* directly comparable, nor are the results of operations for the *three* months ended *March 31, 2018* and *March 31, 2017*.

Adopted Accounting Pronouncements

In *May 2014*, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) *2014-09*, “Revenue from Contracts with Customers,” amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The amended guidance, herein referred to as Topic *606*, is effective for annual and interim reporting periods beginning after *December 15, 2017*, with early adoption permitted for public companies effective for annual and interim reporting periods beginning after *December 15, 2016*. The Company adopted the new revenue standard in the *first* quarter of fiscal year *2018* using the modified retrospective method. The Company recognized the cumulative effect of applying the new revenue standard as an adjustment to retained earnings. The comparative information has *not* been restated and continues to be reported under the accounting standards in effect for the period presented.

See Note 2 – Revenue Recognition, for additional accounting policy and transition disclosures.

In *August 2016*, the FASB issued ASU *2016-15*, Statement of Cash Flows (Topic *230*), which intends to reduce diversity in practice in how certain cash receipts and cash payments are classified in the statement of cash flows. This guidance is effective for the Company in the *first* quarter of *2018*. The Company adopted the standard in the *first* quarter of fiscal year *2018*. The adoption did *not* have any material impact on the Company’s consolidated financial statements.

In *November 2016*, the FASB issued ASU *2016-18*, Statement of Cash Flows (Topic *320*), which amended the guidance on the classification and presentation of restricted cash in the statement of cash flow. The amendment requires entities to include restricted cash and restricted cash equivalents in its cash and cash equivalents in the statement of cash flow. The amendment is effective for the Company in the *first* quarter of *2018* and is required to be adopted retrospectively. The Company adopted the standard in the *first* quarter of fiscal year *2018*. The adoption did *not* have any material impact on the Company’s consolidated financial statements.

Other Accounting Pronouncements

In *February 2016*, the FASB issued ASU No. 2016-02, Leases (Topic 842), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). The new standard also requires expanded disclosures regarding leasing arrangements. The new standard becomes effective for the Company in the *first* quarter of fiscal year 2019 and early adoption is permitted. The new standard is required to be adopted using the modified retrospective approach and requires application of the new standard at the beginning of the earliest comparative period presented. The Company finances its fleet of vehicles used by its field sales and service employees and has facility leases. Several of the Company's customers finance purchases of its system products through *third* party lease companies and *not* directly with the Company. The Company does *not* believe that the new standard will change customer buying patterns or behaviors for its products. The Company will adopt the new standard effective *January 1, 2019*. The Company expects that upon adoption, right-of-use assets and lease liabilities will be recognized in the balance sheet in amounts that will be material.

Note 2. Revenue recognition

The Company adopted ASC Topic 606, Revenue from Contracts with Customers, on *January 1, 2018*, applying the modified retrospective method to all contract agreements that were *not* completed as of *January 1, 2018*. Results for reporting periods beginning after *January 1, 2018* are presented under Topic 606, while prior period amounts are *not* adjusted and continue to be reported under the accounting standards in effect for the prior period. A cumulative catch up adjustment was recorded to beginning retained earnings to reflect the impact of all existing arrangements under Topic 606.

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Upon adoption of the Topic 606, the Company recorded an increase to retained earnings of \$5.0 million for contracts still in force as of *January 1, 2018* for the following items in the *first* quarter of 2018:

\$237,000 reduction in deferred revenue balances for the differences in the amount of revenue recognition for the Company's revenue streams as a result of allocation of revenue based on standalone selling prices to the Company's various performance obligations.

\$151,000 increase in deferred revenue balances, related to the accretion of financing costs for multi-year post-warranty service contracts for customers who pay more than one year in advance of receiving the service. The Company estimated interest expense for such advance payments under the new revenue standard.

\$210,000 for variable consideration on sale transactions.

\$4.7 million for the capitalization of the incremental contract acquisition costs, such as sales commissions paid in connection with system sales. These contract acquisition costs were capitalized and amortized over the period of anticipated support renewals. Under the prior guidance, the Company expensed such costs when incurred.

The Company's revenue consists of product and service revenue resulting from the sale of systems, training on the systems, extended service contracts, consumables and other accessories. The Company accounts for a contract with a customer when there is a legally enforceable contract between the Company and the customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. Revenues are recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services.

The Company's system sale arrangements generally contain multiple products and services. For these bundled sale arrangements, the Company accounts for individual products and services as separate performance obligations if they are distinct, which is if a product or service is separately identifiable from other items in the bundled package, and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company's system sale arrangements include a combination of the following performance obligations: The System and software license (considered as *one* performance obligation), system accessories (hand pieces), training, other accessories, extended service contracts and marketing services. For the Company's system sale arrangements that include an extended service contract, the period of service commences at the expiration of the Company's standard warranty offered at the time of the system sale. The Company considers the extended service contracts terms in the arrangements that are legally enforceable to be performance obligations. Other than service and training, the Company generally satisfies all of the performance obligations at a point in time. System, system accessories (hand pieces), training, and service are also sold on a stand-alone basis, and related performance obligations are satisfied over time as the services are performed.

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The following table summarizes the effects of adopting Topic 606 on the Company's condensed consolidated balance sheet as of *March 31, 2018*:

	As reported under	Adjustments	Balances under
	Topic 606		Prior GAAP
	(In thousands)		
Other long-term assets	5,367	4,862	505
Accrued Liabilities	20,083	(111)	20,194
Deferred revenue	11,015	(194)	10,821
Retained earnings	5,888	5,167	721

The following table summarizes the effects of adopting Topic 606 on Company's condensed consolidated income statement for the *three* months ended *March 31, 2018*:

	As reported under	Adjustments	Balances under
	Topic 606		Prior GAAP
	(In thousands, except per share amounts)		
Products revenue	\$29,264	\$ 10	\$29,254
Service revenue	4,861	64	4,797
Sales and marketing	13,088	(185)	13,273
Interest and other income, net*	98	(65)	163

* Included in interest and other income, net is the estimated interest expense for advance payment related to contract services under the new revenue standard going forward. Adoption of the standard had no impact to total net cash from or used in operating, investing, or financing activities within the Condensed Consolidated Statements of Cash Flows.

As part of the Company's adoption of ASC 606, the Company elected to use the following practical expedients (i) not to adjust the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less; (ii) to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less; (iii) not to recast revenue for contracts that begin and end in the same fiscal year; and (iv) not to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.

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The Company invests its cash primarily in money market funds and in highly liquid debt instruments of U.S. federal and municipal governments and their agencies, commercial paper and corporate debt securities. All highly liquid investments with stated maturities of *three* months or less from date of purchase are classified as cash equivalents; all highly liquid investments with stated maturities of greater than *three* months are classified as marketable investments. The majority of the Company's cash and investments are held in U.S. banks and its foreign subsidiaries maintain a limited amount of cash in their local banks to cover their short term operating expenses.

The Company determines the appropriate classification of its investments in marketable securities at the time of purchase and re-evaluates such designation at each balance sheet date. The Company's marketable securities have been classified and accounted for as available-for-sale. Investments with remaining maturities more than *one* year are viewed by the Company as available to support current operations, and are classified as current assets under the caption marketable investments in the accompanying Consolidated Balance Sheets. Investments in marketable securities are carried at fair value, with the unrealized gains and losses reported as a component of stockholders' equity. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of interest and other income, net.

The following tables summarize the components, and the unrealized gains and losses position, related to the Company's cash, cash equivalents and marketable investments (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
March 31, 2018				
Cash and cash equivalents:				
Cash	\$ 10,579	\$ —	\$ —	\$ 10,579
Money market funds	331	—	—	331
Total cash and cash equivalents	10,910	—	—	10,910
Marketable investments:				
U.S. government notes	7,110	—	(14)	7,096
Municipal securities	201	—	(1)	200
Corporate debt securities	5,795	1	(30)	5,766
Total marketable investments	13,106	1	(45)	13,062
Total cash, cash equivalents and marketable investments	\$ 24,016	\$ 1	\$ (45)	\$ 23,972

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Cash and cash equivalents:				
Cash	\$ 14,058	\$ —	\$ —	\$ 14,058
Money market funds	126	—	—	126
Total cash and cash equivalents	14,184	—	—	14,184
Marketable investments:				
U.S. government notes	11,885	—	(15)	11,870
Municipal securities	201	—	(1)	200
Commercial paper	1,836	—	(3)	1,833
Corporate debt securities	7,838	2	(15)	7,825
Total marketable investments	21,760	2	(34)	21,728
Total cash, cash equivalents and marketable investments	\$ 3			