STREAMLINE HEALTH SOLUTIONS INC.
Form 10-K
April 10, 2017
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K
(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 31, 2017
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: 000-28132

STREAMLINE HEALTH SOLUTIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	31-1455414
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1230 Peachtree Street, NE, Suite 600,
Atlanta, GA 30309
(Address of principal executive offices) (Zip Code)
(404) 920-2396
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
Common Stock, $.01 par value
(Title of Class)
The NASDAQ Stock Market, Inc.
(Name of exchange on which listed)
Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such

files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed using the closing price as reported by The NASDAQ Stock Market, Inc. for the Registrant's Common Stock on July 31, 2016, was $25,850,434.

The number of shares outstanding of the Registrant's Common Stock, $.01 par value, as of March 20, 2017: 19,674,122.

Documents incorporated by reference:

Portions of Streamline's Proxy Statement for its 2017 Annual Meeting of Stockholders are incorporated by reference into Part III.

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FORWARD-LOOKING STATEMENTS

We make forward-looking statements in this Report and in other materials we file with the Securities and Exchange Commission ("SEC") or otherwise make public. In this Report, both Part I, Item 1, "Business," and Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," contain forward-looking statements. In addition, our senior management makes forward-looking statements to analysts, investors, the media and others. Statements with respect to expected revenue, income, receivables, backlog, client attrition, acquisitions and other growth opportunities, sources of funding operations and acquisitions, the integration of our solutions, the performance of our channel partner relationships, the sufficiency of available liquidity, research and development, and other statements of our plans, beliefs or expectations are forward-looking statements. These and other statements using words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "target," "can," "could," "may," "would" and similar expressions also are forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement. The forward-looking statements we make are not guarantees of future performance, and we have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate under the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. Management cautions against putting undue reliance on forward-looking statements or projecting any future results based on such statements or present or historical earnings levels.

Among the factors that could cause actual future results to differ materially from our expectations are the risks and uncertainties described under "Risk Factors" set forth in Part I, Item 1A, and the other cautionary statements in other documents we file with the SEC, including the following:

- competitive products and pricing;
- product demand and market acceptance;
- entry into new markets;
- new product and services development and commercialization;
- key strategic alliances with vendors that resell our products;
- uncertainty in continued relationships with clients due to termination rights;
- our ability to control costs;
- availability of products produced by third-party vendors;
- the healthcare regulatory environment;
- potential changes in legislation, regulation and government funding affecting the healthcare industry;
- healthcare information systems budgets;
- availability of healthcare information systems trained personnel for implementation of new systems, as well as maintenance of legacy systems;
- the success of our relationships with channel partners;
- fluctuations in operating results;
- critical accounting policies and judgments;
- changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other standard-setting organizations;
- changes in economic, business and market conditions impacting the healthcare industry and the markets in which we operate; and
- our ability to maintain compliance with the terms of our credit facilities.

Most of these factors are beyond our ability to predict or control. Any of these factors, or a combination of these factors, could materially affect our future financial condition or results of operations and the ultimate accuracy of our forward-looking statements. There also are other factors that we may not describe (generally because we currently do

not perceive them to be material) that could cause actual results to differ materially from our expectations.

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We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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PART I

ITEM 1. Business

Company Overview

Incorporated in 1989, the Company is a leading provider of transformational data-driven solutions for healthcare organizations. The Company provides computer software-based solutions through its Looking Glass® platform. Looking Glass® captures, aggregates and translates structured and unstructured data to deliver intelligently organized, easily accessible predictive insights to its clients. Hospitals and physician groups use the knowledge generated by the Looking Glass® platform to help them reduce exposure to risk, improve clinical, financial and operational performance and improve patient care.

The Company's software solutions are delivered to clients either by a purchased fixed-term or perpetual license, where such software is installed locally in the client's data center, or by access to the Company's data center systems through a secure connection in a software as a service ("SaaS") delivery method.

The Company operates exclusively in one segment as a provider of health information technology solutions and associated services that improve healthcare processes and information flows within a healthcare facility. The Company sells its solutions and services in North America to hospitals and health systems, including physician practices, through its direct sales force and its reseller partnerships.

Unless the context requires otherwise, references to "Streamline Health," the "Company," "we," "us" and "our" are intended to mean Streamline Health Solutions, Inc. and its wholly-owned subsidiary. All references to a fiscal year refer to the fiscal year commencing February 1 in that calendar year and ending on January 31 of the following calendar year.

Solutions

The Company offers solutions to assist its clients in key areas of the patient care revenue and engagement lifecycle including Patient Care, Health Information Management (HIM), Coding and Clinical Documentation Improvement (CDI) and Financial Management. Each suite of solutions is designed to improve the flow of critical patient information throughout the enterprise. Each of the Company's solutions helps to transform and structure information between disparate information technology systems into actionable data, giving the end user comprehensive access to clinical and business intelligence to enable better decision-making. Solutions can be delivered either by a perpetual license installed locally, or by a fixed-term license installed locally or accessed securely through SaaS, with many solutions being available on all three models.

Patient Care Solutions - These solutions, which include the Company's Business Analytics and Clinical Analytics solutions, enable healthcare providers to improve their patient care through individual workflows such as clinical analytics, operating room management, physician portal and care coordination. These solutions are accessible through the Company's Looking Glass® platform, which delivers industry-leading clinical analytics that foster an open, continuous learning culture inside a healthcare organization, empowering it with real-time, on-demand predictive insight for improved patient outcomes.

HIM, Coding & CDI Solutions - These solutions provide an integrated web-based software suite that enhances the productivity of CDI and Coding staff and enables the seamless sharing of patient data. This suite of solutions includes individual workflows such as content management, release of information, computer-assisted coding (eCAC), CDI, abstracting and physician query. The eCAC solution includes patented Natural Language Processing (NLP) that streamlines concurrent chart review and coding workflows.

Financial Management Solutions - These solutions enable staff across the healthcare enterprise to drill down quickly and deeply into actionable and real-time financial data and key performance indicators to improve revenue realization and staff efficiency. This suite of solutions includes individual workflows such as accounts receivable management, denials management, claims processing, spend management and audit management. These solutions provide dashboards, data mining tools and prescriptive reporting, which help to simplify, facilitate and optimize overall revenue cycle performance of the healthcare enterprise. These solutions are also used to increase the completion and

accuracy of patient charts and related coding, improve accounts receivable collections, reduce and manage denials, and improve audit outcomes.

Services

Audit Services — The Company provides technology-enabled coding audit services to help clients review and optimize their internal clinical documentation and coding functions across the applicable segment of the client's enterprise. The Company provides these services using experienced auditors and proprietary software solutions, as well as third-party solutions that assist the audit team in performing its role and interacting with clients. The audit services are provided for inpatient DRG coding auditing, outpatient APC auditing, HCC auditing and Physician/ProFee services coding auditing.

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Custom Integration Services — The Company's professional services team works with clients to design custom integrations that integrate data to or from virtually any clinical, financial, or administrative system. By taking data and documents from multiple, disparate systems and bringing them into one streamlined system, clients are able to maximize efficiencies and increase operational performance. The Company's professional services team also creates custom integrations that transfer data from the Company's solutions into the client's external or internal systems.
Training Services — Training courses are offered to help clients quickly learn to use our solutions in the most efficient manner possible. Training sessions are available on-site or off-site for multiple staff members or as few as one person.
Electronic Image Conversion — The Company's electronic image conversion service allows organizations to protect their repository of images while taking advantage of its content management technology. Electronic image conversion creates one repository that integrates directly with our clinical content management system. This service is available via the SaaS model or for locally-installed solutions.
Database Monitoring Services — The Company's advanced database monitoring services for clients with locally-installed solutions help lighten the burden of ongoing system monitoring by the client's information technology staff and ensure a continual, stable production environment. The Company's database administrators ensure the client's system is running optimally with weekly manual checks of the database environment to identify system issues that may require further attention. Monitoring is done through protected connections to data security.

Clients and Strategic Partners

The Company continues to provide transformational data-driven solutions to some of the finest, most well-respected healthcare enterprises in the United States and Canada. Clients are geographically dispersed throughout North America, with the heaviest concentration currently in the New York metropolitan area. The Company provides these solutions through a combination of direct sales and relationships with strategic channel partners. Additional information on certain key channel partner relationships the Company established this year can be found in our filings and press releases for fiscal 2016.

During fiscal year 2016, one individual client accounted for 10% or more of our total revenues. Three clients each represented 11% of total accounts receivable as of January 31, 2017.

During fiscal year 2015, no individual client accounted for 10% or more of our total revenues. Two clients represented 13% and 12%, respectively, of total accounts receivable as of January 31, 2016.

For more information regarding our major clients, please see "Risks Relating to Our Business - Our sales have been concentrated in a small number of clients" in Part 1, Item 1A, "Risk Factors".

Acquisitions and Divestitures

The Company regularly evaluates opportunities for acquisitions and divestitures for portions of the Company that may not align with current growth strategies. The Company acquired substantially all of the assets of Opportune IT Healthcare Solutions, Inc. ("Opportune IT"), a provider of coding compliance, recovery audit contractor consulting, and ICD-10 readiness and training to hospitals, physicians and medical groups, on September 8, 2016. The Company also divested the Looking Glass® Patient Engagement suite of solutions on December 1, 2016. Additional details regarding these acquisitions and divestitures as well as other key historic acquisitions and divestitures occurring prior to fiscal 2016 are further discussed in Note 3 - Acquisitions and Divestitures to our consolidated financial statements included in Part II, Item 8 herein.

Business Segments

We manage our business as one single business segment. For our total assets at January 31, 2017 and 2016 and total revenue and net loss for the fiscal years ended January 31, 2017 and 2016, see our consolidated financial statements included in Part II, Item 8 herein.

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Contracts, License and Services Fees

The Company enters into agreements with its clients that specify the scope of the system to be installed and/or services to be provided by the Company, as well as the agreed-upon aggregate price, applicable term duration and the timetable for the associated licenses and services.

For clients purchasing software to be installed locally or provided on a SaaS model, these are multi-element arrangements that include either a perpetual or term license and right to access the applicable software functionality (whether installed locally at the client site or the right to use the Company's solutions as a part of SaaS services), terms regarding maintenance and support services, terms for any third-party components such as hardware and software, and professional services for implementation, integration, process engineering, optimization and training, as well as fees and payment terms for each of the foregoing. If the client purchases solutions on a perpetual license model, the client is billed the license fee up front. Maintenance and support is provided on a term basis for separate fees, with an initial term typically from one to five years in length. The maintenance and support fee is charged annually in advance, commencing either upon contract execution or deployment of the solution in live production. If the client purchases solutions on a term-based model, the client is billed periodically a combined access fee for a specified term, typically from one to seven years in length. The access fee includes the access rights along with all maintenance and support services.

The Company also generally provides software and SaaS clients professional services for implementation, integration, process engineering, optimization and training. These services and the associated fees are separate from the license, maintenance and access fees. Professional services are provided on either a fixed-fee or hourly arrangements billable to clients based on agreed-to payment milestones (fixed fee) or monthly payment structure on hours incurred (hourly). These services can either be included at the time the related locally installed software or SaaS solution is licensed as part of the initial purchase agreement, or added on afterward as an addendum to the existing agreement for services required after the initial implementation.

For coding audit services clients, these review services are provided either through a stand-alone services agreement or services addendum to an existing master agreement with the client. These review services are available as either a one-time service or recurring monthly, quarterly or annual review structure. These services are typically provided on a per reviewed account/chart basis. Monthly minimums are required where material discounts have been offered. Payment typically occurs upon completion of the applicable review project.

The commencement of revenue recognition varies depending on the size and complexity of the system and/or services involved, the implementation or performance schedule requested by the client and usage by clients of SaaS for software-based components. The Company's agreements are generally non-cancelable but provide that the client may terminate its agreement upon a material breach by the Company and/or or may delay certain aspects of the installation or associated payments in such events. And the Company does allow for termination for convenience in certain situations. Therefore, it is difficult for the Company to accurately predict the revenue it expects to achieve in any particular period, and a termination or installation delay of one or more phases of an agreement, or the failure of the Company to procure additional agreements, could have a material adverse effect on the Company's business, financial condition, and results of operations, as further discussed in Section 1A Risk Factors herein. Historically, the Company has not experienced a material amount of contract cancellations; however, the Company sometimes experiences delays in the course of contract performance and the Company accounts for them accordingly.

Third-Party License Fees

The Company incorporates software licensed from various third-party vendors into its proprietary software. Stand-alone third-party software is also required to operate certain of the Company's proprietary software and/or SaaS services. The Company licenses these software products and pays the required license fees when such software is delivered to clients. For information regarding royalty agreements, see Note 3 - Acquisitions and Divestitures to our consolidated financial statements included in Part II, Item 8 herein.

Associates

As of January 31, 2017, the Company had 129 employees (with 127 as full-time employees and 2 as part-time employees), a net increase of 6 during fiscal 2016. The Company utilizes independent contractors to supplement its staff, as needed. None of the Company's associates are represented by a labor union or subject to a collective bargaining agreement. The Company has never experienced a work stoppage and believes that its employee relations are good. The Company's success depends, to a significant degree, on its management, sales and technical personnel. For more information on contracts, backlog, acquisitions and research and development, see also Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Competition

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Regarding our Patient Care Solutions, HIM, Coding and CDI Solutions and Financial Management Solutions, several companies historically have dominated the clinical information system software market and several of these companies have either acquired, developed or are developing their own document management and workflow technologies. The industry is undergoing consolidation and realignment as companies position themselves to compete more effectively. Strategic alliances between vendors offering HIM workflow and document management technologies and vendors of other healthcare systems are increasing. Barriers to entry to this market include technological and application sophistication, the ability to offer a proven product, creating and utilizing a well-established client base and distribution channels, brand recognition, the ability to operate on a variety of operating systems and hardware platforms, the ability to integrate with pre-existing systems and capital for sustained development and marketing activities. The Company has many competitors including clinical information system vendors that are larger, more established and have substantially more resources than the Company.

Regarding our Audit Services, there are numerous medium and small companies and independent consultants who offer these services. Barriers to entry to this market include creating and utilizing a well-established client base and distribution channels, brand recognition, establishing differentiators for our services and capital for sustained development and marketing activities.

The Company believes that these obstacles taken together represent a moderate to high-level barrier to entry. The Company believes that the principal competitive factors in its market are client recommendations and references, company reputation, system reliability, system features and functionality (including ease of use), technological advancements, client service and support, breadth and quality of the systems, the potential for enhancements and future compatible products, the effectiveness of marketing and sales efforts, price, and the size and perceived financial stability of the vendor. In addition, the Company believes that the speed with which companies in its market can anticipate the evolving healthcare industry structure and identify unmet needs are important competitive factors.

Additional Intellectual Property Rights

In addition to the software licenses described in other sections of this Item 1, “Business”, the Company also holds registered trademarks for its Looking Glass®, Streamline Health® and other key trademarks used in selling our products. These marks are currently active, with registrations being valid for a period of 3 years each. The Company actively renews these marks at the end of each registration period.

Regulation

Our clients derive a substantial portion of their revenue from third-party private and governmental payors, including through Medicare, Medicaid and other government-sponsored programs. Our clients also have express handling and retention obligations under information-based laws such as the Health Insurance Portability and Accountability Act of 1996. There are no material regulatory proposals of which the Company is aware that we believe currently have a high likelihood of passage that we anticipate would have a material impact on the operation or demand of the Company’s products and services. However, the Company acknowledges there is currently great uncertainty in the US healthcare market generally from a regulatory perspective. Material changes could have unanticipated impact on demand or usability of the Company’s solutions, require the Company to incur additional development and/or operating costs (on a one-time or recurring basis) or cause clients to terminate their agreements or otherwise be unable to pay amounts owed to the Company, as further discussed in the risk factors in Part 1, Item 1A, “Risk Factors” herein.

Requests for Documents

Copies of documents filed by the Company with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and all amendments to those reports and statements, if any, can be found at the web site http://investor.streamlinehealth.net as soon as practicable after such material is electronically filed with, or furnished to, the SEC. The information contained on the Company's website is not part of, or incorporated by reference into, this annual report on Form 10-K. Copies can be downloaded free of charge from the Company's web site or directly from the SEC web site, http://www.sec.gov. Also, copies of the Company’s annual report on Form 10-K will be made available, free of charge, upon written request to the Company, attention: Corporate Secretary, 1230 Peachtree Street, NE, Suite 600, Atlanta, GA 30309.

Materials that the Company files with the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ITEM 1A. Risk Factors

An investment in our common stock or other securities involves a number of risks. You should carefully consider each of the risks described below before deciding to invest in our common stock or other securities. If any of the following risks

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develops into actual events, our business, financial condition or results of operations could be negatively affected, the market price of our common stock or other securities could decline, and you may lose all or part of your investment.

Risks Relating to Our Business

Our sales have been concentrated in a small number of clients.
Our revenues have been concentrated in a relatively small number of large clients, and we have historically derived a substantial percentage of our total revenues from a few clients. For the fiscal years ended January 31, 2017 and 2016, our five largest clients accounted for 30% and 28% of our total revenues, respectively. If one or more clients terminate all or any portion of a master agreement, delay installations or if we fail to procure additional agreements, there could be a material adverse effect on our business, financial condition and results of operations. See Note 9 - Major Clients to our consolidated financial statements included in Part II, Item 8 herein for further notes regarding representation of the largest individual major clients.

A significant increase in new SaaS contracts could reduce near-term profitability and require a significant cash outlay, which could adversely affect near term cash flow and financial flexibility.
If new or existing clients purchase significant amounts of our SaaS services, we may have to expend a significant amount of initial setup costs and time before those new clients are able to begin using such services, and we cannot begin to recognize revenues from those SaaS agreements until the commencement of such services. Accordingly, we anticipate that our near-term cash flow, revenue and profitability may be adversely affected by significant incremental setup costs from new SaaS clients that would not be offset by revenue until new SaaS clients go into production. While we anticipate long-term growth in profitability through increases in recurring SaaS subscription fees and significantly improved profit visibility, any inability to adequately finance setup costs for new SaaS solutions could result in the failure to put new SaaS solutions into production, and could have a material adverse effect on our liquidity, financial position and results of operations. In addition, this near-term cash flow demand could adversely impact our financial flexibility and cause us to forego otherwise attractive business opportunities or investments.

Our coding audit services and associated software and technologies represent a new market for the Company, and we may not see the anticipated market interest or growth due to being a new player in the industry.
The Company is currently investing in new software-based technologies relating to high automation and machine-based analytics regarding a client’s coding audit process. These technologies have previously been used solely for internal purposes and have not been commercialized. The return on this investment requires that the product developments are completed in a timely and cost-effective manner, there is general interest in the marketplace (for both existing and future clients) for this technology, the demand for the product generates sufficient revenue in light of the development costs and that the Company is able to execute and successful product launch for these technologies. If the Company is unable to meet these requirements when launching these technologies, or if there is a delay in the launch process, the Company may not see an increase in revenue to offset the current development costs or otherwise translate to added growth and revenue for the Company.

Clients may exercise termination rights within their contracts, which may cause uncertainty in anticipated and future revenue streams.
The Company generally does not allow for termination of a client’s agreement except at the end of the agreed upon term or for cause. However, certain of the Company’s client contracts provide that the client may terminate the contract without cause prior to the end of the term of the agreement by providing written notice, sometimes with relatively short notice periods. Furthermore, there can be no assurance that a client will not cancel all or any portion of an agreement, even without an express early termination right. And, the Company may face additional costs or hardships collecting on amounts owed if a client terminates an agreement without such a right. Whether resulting from

termination for cause or the limited termination for convenience rights discussed above, the existence of contractual relationships with these clients is not an assurance that we will continue to provide services for our clients through the entire term of their respective agreements. If clients representing a significant portion of our revenue terminated their agreements unexpectedly, we may not, in the short-term, be able to replace the revenue and income from such contracts and this would have a material adverse effect on the Company's business, financial condition, results of operations and cash flows. In addition, client contract terminations could harm our reputation within the industry, especially any termination for cause, which could negatively impact our ability to obtain new clients.

Changes in healthcare regulations impacting coding, payers and other aspects of the healthcare regulatory cycle could have substantial impact on our financial performance, growth and operating costs.

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Our sales and profitability depend, in part, on the extent to which coverage of and reimbursement for medical care provided is available from governmental health programs, private health insurers, managed care plans and other third-party payors. Unanticipated regulatory changes could materially impact the need for and/or value of our solutions. For example, if governmental or other third-party payors materially reduce reimbursement rates or fail to reimburse our clients adequately, our clients may suffer adverse financial consequences. Changes in regulations affecting the healthcare industry, such as any increased regulation by governmental agencies of the purchase and sale of medical products, or restrictions on permissible discounts and other financial arrangements, could also directly impact the capabilities our solutions and services provide and the pricing arrangements we are required to offer to be competitive in the market. Similarly, the U.S. Congress may adopt legislation that may change, override, conflict with or preempt the currently existing regulations and which could restrict the ability of clients to obtain, use or disseminate patient health information and/or impact the value of the functionality our products and services provide. These situations would, in turn, reduce the demand for our solutions or services and/or the ability for a client to purchase our solutions or services. This could have a material impact on our financial performance. In addition, the speed with which the Company can respond to and address any such changes when compared with the response of other companies in the same market (especially companies who may accurately anticipate the evolving healthcare industry structure and identify unmet needs) are important competitive factors. If the Company is not able to address the modifications in a timely manner compared with our competition, that may further reduce demand for our solutions and services.

The potential impact on us of new or changes in existing federal, state and local regulations governing healthcare information could be substantial.

Healthcare regulations issued to date have not had a material adverse effect on our business. However, we cannot predict the potential impact of new or revised regulations that have not yet been released or made final, or any other regulations that might be adopted. The U.S. Congress may adopt legislation that may change, override, conflict with or preempt the currently existing regulations and which could restrict the ability of clients to obtain, use or disseminate patient health information. Although the features and architecture of our existing solutions can be modified, it may be difficult to address the changing regulation of healthcare information.

The healthcare industry is highly regulated. Any material changes in the political, economic or regulatory healthcare environment that affect the group purchasing business or the purchasing practices and operations of healthcare organizations, or that lead to consolidation in the healthcare industry, could require us to modify our services or reduce the funds available to providers to purchase our solutions and services.

Our business, financial condition and results of operations depend upon conditions affecting the healthcare industry generally and hospitals and health systems particularly. Our ability to grow will depend upon the economic environment of the healthcare industry, as well as our ability to increase the number of solutions that we sell to our clients. The healthcare industry is highly regulated and is subject to changing political, economic and regulatory influences. Factors such as changes in reimbursement policies for healthcare expenses, consolidation in the healthcare industry, regulation, litigation and general economic conditions affect the purchasing practices, operation and, ultimately, the operating funds of healthcare organizations. In particular, changes in regulations affecting the healthcare industry, such as any increased regulation by governmental agencies of the purchase and sale of medical products, or restrictions on permissible discounts and other financial arrangements, could require us to make unplanned modifications to our solutions and services, or result in delays or cancellations of orders or reduce funds and demand for our solutions and services.

Our clients derive a substantial portion of their revenue from third-party private and governmental payors, including through Medicare, Medicaid and other government-sponsored programs. Our sales and profitability depend, in part, on the extent to which coverage of and reimbursement for medical care provided is available from governmental health programs, private health insurers, managed care plans and other third-party payors. If governmental or other

third-party payors materially reduce reimbursement rates or fail to reimburse our clients adequately, our clients may suffer adverse financial consequences, which in turn, may reduce the demand for and ability to purchase our solutions or services.

We face significant competition, including from companies with significantly greater resources.
We currently compete with many other companies for the licensing of similar software solutions and related services. Several companies historically have dominated the clinical information systems software market and several of these companies have either acquired, developed or are developing their own content management, analytics and coding/clinical documentation improvement solutions, as well as the resultant workflow technologies. The industry is undergoing consolidation and realignment as companies position themselves to compete more effectively. Many of these companies are larger than us and have significantly more resources to invest in their business. In addition, information and document

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management companies serving other industries may enter the market. Suppliers and companies with whom we may establish strategic alliances also may compete with us. Such companies and vendors may either individually, or by forming alliances excluding us, place bids for large agreements in competition with us. A decision on the part of any of these competitors to focus additional resources in any one of our three solutions stacks (content management, analytics and coding/clinical documentation improvement), workflow technologies and other markets addressed by us could have a material adverse effect on us.

The healthcare industry is evolving rapidly, which may make it more difficult for us to be competitive in the future. The U.S. healthcare system is under intense pressure to improve in many areas, including modernization, universal access and controlling skyrocketing costs of care. We believe that the principal competitive factors in our market are client recommendations and references, company reputation, system reliability, system features and functionality (including ease of use), technological advancements, client service and support, breadth and quality of the systems, the potential for enhancements and future compatible solutions, the effectiveness of marketing and sales efforts, price and the size and perceived financial stability of the vendor. In addition, we believe that the speed with which companies in our market can anticipate the evolving healthcare industry structure and identify unmet needs is an important competitive factor. If we are unable to keep pace with changing conditions and new developments, we will not be able to compete successfully in the future against existing or potential competitors.

Rapid technology changes and short product life cycles could harm our business.
The market for our solutions and services is characterized by rapidly changing technologies, regulatory requirements, evolving industry standards and new product introductions and enhancements that may render existing solutions obsolete or less competitive. As a result, our position in the healthcare information technology market could change rapidly due to unforeseen changes in the features and functions of competing products, as well as the pricing models for such products. Our future success will depend, in part, upon our ability to enhance our existing solutions and services and to develop and introduce new solutions and services to meet changing requirements. Moreover, competitors may develop competitive products that could adversely affect our operating results. We need to maintain an ongoing research and development program to continue to develop new solutions and apply new technologies to our existing solutions but may not have sufficient funds with which to undertake such required research and development. If we are not able to foresee changes or to react in a timely manner to such developments, we may experience a material, adverse impact on our business, operating results and financial condition.

Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our solutions and services.
Our intellectual property, which represents an important asset to us, has some protection against infringement through copyright and trademark law. We generally have little patent protection on our software. We rely upon license agreements, employment agreements, confidentiality agreements, nondisclosure agreements and similar agreements to maintain the confidentiality of our proprietary information and trade secrets. Notwithstanding these precautions, others may copy, reverse engineer or independently design technology similar to our solutions. If we fail to protect adequately our intellectual property through trademarks and copyrights, license agreements, employment agreements, confidentiality agreements, nondisclosure agreements or similar agreements, our intellectual property rights may be misappropriated by others, invalidated or challenged, and our competitors could duplicate our technology or may otherwise limit any competitive technology advantage we may have. It may be necessary to litigate to enforce or defend our proprietary technology or to determine the validity of the intellectual property rights of others. Any litigation, successful or unsuccessful, may result in substantial cost and require significant attention by management and technical personnel.
Due to the rapid pace of technological change, we believe our future success is likely to depend upon continued innovation, technical expertise, marketing skills and client support and services rather than on legal protection of our

intellectual property rights. However, we have aggressively asserted our intellectual property rights when necessary and intend to do so in the future.

We could be subjected to claims of intellectual property infringement that could be expensive to defend.
While we do not believe that our solutions and services infringe upon the intellectual property rights of third parties, the potential for intellectual property infringement claims continually increases as the number of software patents and copyrighted and trademarked materials continues to rapidly expand. Any claim for intellectual property right infringement, even if not meritorious, could be expensive to defend. If we were held liable for infringing third party intellectual property rights, we could incur substantial damage awards, and potentially be required to cease using the technology, produce non-infringing technology or obtain a license to use such technology. Such potential liabilities or increased costs could be material to us.

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Over the last several years, we have completed a number of acquisitions and may undertake additional acquisitions in the future. Any failure to adequately integrate past and future acquisitions into our business could have a material adverse effect on us.

Over the last several years, we have completed several acquisitions of businesses through asset and stock purchases. We expect that we will make additional acquisitions in the future.

Acquisitions involve a number of risks, including, but not limited to:

- the potential failure to achieve the expected benefits of the acquisition, including the inability to generate sufficient revenue to offset acquisition costs, or the inability to achieve expected synergies or cost savings;
- unanticipated expenses related to acquired businesses or technologies and their integration into our existing businesses or technology;
- the diversion of financial, managerial and other resources from existing operations;
- the risks of entering into new markets in which we have little or no experience or where competitors may have stronger positions;
- potential write-offs or amortization of acquired assets or investments;
- the potential loss of key employees, clients or partners of an acquired business;
- delays in client purchases due to uncertainty related to any acquisition;
- potential unknown liabilities associated with an acquisition; and
- the tax effects of any such acquisitions.

If we fail to successfully integrate acquired businesses or fail to implement our business strategies with respect to acquisitions, we may not be able to achieve projected results or support the amount of consideration paid for such acquired businesses, which could have an adverse effect on our business and financial condition.

Finally, if we finance acquisitions by issuing equity or convertible or other debt securities, our existing stockholders may be diluted, or we could face constraints related to the terms of and repayment obligations related to the incurrence of indebtedness. This could adversely affect the market price of our securities.

Third party products are essential to our software.

Our software incorporates software licensed from various vendors into our proprietary software. In addition, third-party, stand-alone software is required to operate some of our proprietary software modules. The loss of the ability to use these third-party products, or ability to obtain substitute third-party software at comparable prices, could have a material adverse effect on our ability to license our software.

Our solutions may not be error-free and could result in claims of breach of contract and liabilities.

Our solutions are very complex and may not be error-free, especially when first released. Although we perform extensive testing, failure of any solution to operate in accordance with its specifications and documentation could constitute a breach of the license agreement and require us to correct the deficiency. If such deficiency is not corrected within the agreed-upon contractual limitations on liability and cannot be corrected in a timely manner, it could constitute a material breach of a contract allowing the termination thereof and possibly subjecting us to liability. Also, we sometimes indemnify our clients against third-party infringement claims. If such claims are made, even if they are

without merit, they could be expensive to defend. Our license and SaaS agreements generally limit our liability arising from these types of claims, but such limits may not be enforceable in some jurisdictions or under some circumstances. A significant uninsured or under-insured judgment against us could have a material adverse impact on us.

We could be liable to third parties from the use of our solutions.

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Our solutions provide access to patient information used by physicians and other medical personnel in providing medical care. The medical care provided by physicians and other medical personnel are subject to numerous medical malpractice and other claims. We attempt to limit any potential liability of ours to clients by limiting the warranties on our solutions in our agreements with our clients (i.e., healthcare providers). However, such agreements do not protect us from third-party claims by patients who may seek damages from any or all persons or entities connected to the process of delivering patient care. We maintain insurance, which provides limited protection from such claims, if such claims result in liability to us. Although no such claims have been brought against us to date regarding injuries related to the use of our solutions, such claims may be made in the future. A significant uninsured or under-insured judgment against us could have a material adverse impact on us.

Our SaaS and support services could experience interruptions.
We provide SaaS for many clients, including the storage of critical patient, financial and administrative data. In addition, we provide support services to clients through our client support organization. We have redundancies, such as backup generators, redundant telecommunications lines and backup facilities built into our operations to prevent disruptions. However, complete failure of all generators, impairment of all telecommunications lines or severe casualty damage to the primary building or equipment inside the primary building housing our hosting center or client support facilities could cause a temporary disruption in operations and adversely affect clients who depend on the application hosting services. Any interruption in operations at our data center or client support facility could cause us to lose existing clients, impede our ability to obtain new clients, result in revenue loss, cause potential liability to our clients and increase our operating costs.

Our SaaS solutions are provided over an internet connection. Any breach of security or confidentiality of protected health information could expose us to significant expense and harm our reputation.
We provide remote SaaS solutions for clients, including the storage of critical patient, financial and administrative data. We have security measures in place to prevent or detect misappropriation of protected health information. We must maintain facility and systems security measures to preserve the confidentiality of data belonging to clients, as well as their patients, that resides on computer equipment in our data center, which we handle via application hosting services, or that is otherwise in our possession. Notwithstanding efforts undertaken to protect data, it can be vulnerable to infiltration as well as unintentional lapse. If confidential information is compromised, we could face claims for contract breach, penalties and other liabilities for violation of applicable laws or regulations, significant costs for remediation and re-engineering to prevent future occurrences and serious harm to our reputation.

The loss of key personnel could adversely affect our business.
Our success depends, to a significant degree, on our management, sales force and technical personnel. We must recruit, motivate and retain highly skilled managers, sales, consulting and technical personnel, including solution programmers, database specialists, consultants and system architects who have the requisite expertise in the technical environments in which our solutions operate. Competition for such technical expertise is intense. Our failure to attract and retain qualified personnel could have a material adverse effect on us.

Our future success depends upon our ability to grow, and if we are unable to manage our growth effectively, we may incur unexpected expenses and be unable to meet our clients' requirements.
We will need to expand our operations if we successfully achieve greater demand for our products and services. We cannot be certain that our systems, procedures, controls and human resources will be adequate to support expansion of our operations. Our future operating results will depend on the ability of our officers and employees to manage changing business conditions and to implement and improve our technical, administrative, financial control and reporting systems. We may not be able to expand and upgrade our systems and infrastructure to accommodate these increases. Difficulties in managing any future growth, including as a result of integrating any prior or future

acquisition with our existing businesses, could cause us to incur unexpected expenses or render us unable to meet our clients' requirements, and consequently have a significant negative impact on our business, financial condition and operating results.

We may not have access to sufficient or cost-efficient capital to support our growth, execute our business plans and remain competitive in our markets.

As our operations grow and as we implement our business strategies, we expect to use both internal and external sources of capital. In addition to cash flow from normal operations, we may need additional capital in the form of debt or equity to operate and support our growth, execute our business plans and remain competitive in our markets. We may have no or limited availability to such external capital, in which case our future prospects may be materially impaired. Furthermore, we may not be able to access external sources of capital on reasonable or favorable terms. Our business operations could be subject to both

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financial and operational covenants that may limit the activities we may undertake, even if we believe they would benefit our company.

Potential disruptions in the credit markets may adversely affect our business, including the availability and cost of short-term funds for liquidity requirements and our ability to meet long-term commitments, which could adversely affect our results of operations, cash flows and financial condition.

If internally generated funds are not available from operations, we may be required to rely on the banking and credit markets to meet our financial commitments and short-term liquidity needs. Our access to funds under our revolving credit facility or pursuant to arrangements with other financial institutions is dependent on the financial institution's ability to meet funding commitments. Financial institutions may not be able to meet their funding commitments if they experience shortages of capital and liquidity or if they experience high volumes of borrowing requests from other borrowers within a short period of time.

We must maintain compliance with the terms of our existing credit facilities or receive a waiver for any non-compliance. The failure to maintain compliance could have a material adverse effect on our ability to finance our ongoing operations and we may not be able to find an alternative lending source if a default occurs.

In November 2014, we entered into a Credit Agreement (the “Credit Agreement”) with Wells Fargo Bank, N.A., as administrative agent, and other lender parties thereto. Pursuant to the Credit Agreement, the lenders agreed to provide a $10,000,000 senior term loan and a $5,000,000 revolving line of credit to our primary operating subsidiary. In November 2014, the Company repaid indebtedness under its prior credit facility using approximately $7,400,000 of the proceeds provided by the term loan. The prior credit facility with Fifth Third Bank was terminated concurrent with the entry of the Credit Agreement. The Credit Agreement includes customary financial covenants, including the requirements that the Company maintain certain minimum liquidity and achieve certain minimum EBITDA levels. Pursuant to the terms of the second amendment to the Credit Agreement entered into as of April 29, 2016, the Company is required to maintain minimum liquidity of at least $6,500,000 from April 29, 2016 through and including the maturity date of the credit facility. The Company was in compliance with the applicable loan covenants at January 31, 2017. The Credit Agreement also requires the Company to achieve certain minimum EBITDA levels, calculated pursuant to the Credit Agreement and measured on a quarter-end basis, of at least the required amounts in the table set forth in Note 6 - Debt to our consolidated financial statements included in Part II, Item 8 herein for the applicable period set forth therein.

If we do not maintain compliance with all of the continuing covenants and other terms and conditions of the credit facility or secure a waiver for any non-compliance, we could be required to repay outstanding borrowings on an accelerated basis, which could subject us to decreased liquidity and other negative impacts on our business, results of operations and financial condition. Furthermore, if we needed to do so, it may be difficult for us to find an alternative lending source. In addition, because our assets are pledged as a security under our credit facilities, if we are not able to cure any default or repay outstanding borrowings, our assets are subject to the risk of foreclosure by our lenders. Without a sufficient credit facility, we would be adversely affected by a lack of access to liquidity needed to operate our business. Any disruption in access to credit could force us to take measures to conserve cash, such as deferring important research and development expenses, which measures could have a material adverse effect on us.

Our outstanding preferred stock and warrants have significant redemption and repayment rights that could have a material adverse effect on our liquidity and available financing for our ongoing operations.

In August 2012, we completed a private offering of preferred stock, warrants and convertible notes to a group of investors for gross proceeds of $12 million. In November 2012, the convertible notes converted into shares of preferred stock. Subject to the terms of the Subordination and Intercreditor Agreement, the preferred stock is redeemable at the option of the holders thereof anytime after August 31, 2016 if not previously converted into shares of common stock. We may not achieve the thresholds required to trigger automatic conversion of the preferred stock,

and alternatively, holders may not voluntarily elect to convert the preferred stock into common stock. The election of the holders of our preferred stock to redeem the preferred stock could subject us to decreased liquidity and other negative impacts on our business, results of operations and financial condition. Under the terms of the Subordination and Intercreditor Agreement among the preferred stockholders, the Company and Wells Fargo, our obligation to redeem the preferred stock is subordinated to our obligations under the senior term loan and the preferred stock may not be redeemed without the consent of Wells Fargo. For additional information regarding the terms, rights and preferences of the preferred stock and warrants, see Note 14 to our consolidated financial statements included in Part II, Item 8 herein and our other SEC filings.

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Current economic conditions in the U.S. and globally may have significant effects on our clients and suppliers that could result in material adverse effects on our business, operating results and stock price.

Current economic conditions in the U.S. and globally and the concern that the worldwide economy may enter into a prolonged stagnant period could materially adversely affect our clients' access to capital or willingness to spend capital on our solutions and services or their levels of cash liquidity with which to pay for solutions that they will order or have already ordered from us. Continued challenging economic conditions also would likely negatively impact our business, which could result in: (1) reduced demand for our solutions and services; (2) increased price competition for our solutions and services; (3) increased risk of collectability of cash from our clients; (4) increased risk in potential reserves for doubtful accounts and write-offs of accounts receivable; (5) reduced revenues; and (6) higher operating costs as a percentage of revenues.

All of the foregoing potential consequences of the current economic conditions are difficult to forecast and mitigate. As a consequence, our operating results for a particular period are difficult to predict, and, therefore, prior results are not necessarily indicative of future results. Any of the foregoing effects could have a material adverse effect on our business, results ofTD>

any additional terms of the debt warrants, including terms, procedures and limitations relating to the exchange and exercise of such debt warrants.

DESCRIPTION OF DEPOSITARY SHARES

The following briefly summarizes the provisions of the depositary shares and depositary receipts that we may issue from time to time and which would be important to holders of depository shares and depositary receipts, other than pricing and related terms, which will be disclosed in the applicable prospectus supplement. The prospectus supplement will also state whether any of the general provisions summarized below do not apply to the depositary shares or depositary receipts being offered and provide any additional provisions applicable to the depositary shares or depositary receipts being offered. The following description and any description in a prospectus supplement may not be complete and are subject to, and qualified in their entirety by reference to the terms and provisions of the form of deposit agreement filed as an exhibit to the registration statement which contains this prospectus.

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Depositary Shares

We may offer depositary shares evidenced by depositary receipts. Each depositary share represents a fraction or a multiple of a share of a particular series of preferred stock that we issue and deposit with a depositary. The fraction or the multiple of a share of preferred stock, which each depositary share represents, will be set forth in the applicable prospectus supplement.

We will deposit the shares of any series of preferred stock represented by depositary shares according to the provisions of a deposit agreement to be entered into between us and a bank or trust company, which we will select as its preferred stock depositary. We will name the depositary in the applicable prospectus supplement. Each holder of a depositary share will be entitled to all the rights and preferences of the underlying preferred stock in proportion to the applicable fraction or multiple of a share of preferred stock represented by the depositary share. These rights include any applicable dividend, voting, redemption, conversion and liquidation rights. The depositary will send the holders of depositary shares all reports and communications that we deliver to the depositary and which we are required to furnish to the holders of depositary shares.

Depositary Receipts

The depositary shares will be evidenced by depositary receipts issued pursuant to the deposit agreement. Depositary receipts will be distributed to anyone who is buying the fractional shares of preferred stock in accordance with the terms of the applicable prospectus supplement.

Withdrawal of Preferred Stock

Unless the related depositary shares have previously been called for redemption, a holder of depositary shares may receive the number of whole shares of the related series of preferred stock and any money or other property represented by the holder s depositary receipts after surrendering the depositary receipts at the corporate trust office of the depositary, paying any taxes, charges and fees provided for in the deposit agreement and complying with any other requirement of the deposit agreement. Partial shares of preferred stock will not be issued. If the surrendered depositary shares exceed the number of depositary shares that represent the number of whole shares of preferred stock the holder wishes to withdraw, then the depositary will deliver to the holder at the same time a new depositary receipt evidencing the excess number of depositary shares. Once the holder has withdrawn the preferred stock, the holder will not be entitled to re-deposit that preferred stock under the deposit agreement or to receive depositary shares in exchange for such preferred stock.

Dividends and Other Distributions

The depositary will distribute to record holders of depositary shares any cash dividends or other cash distributions it receives on preferred stock. Each holder will receive these distributions in proportion to the number of depositary shares owned by the holder. The depositary will distribute only whole U.S. dollars and cents. The depositary will add any fractional cents not distributed to the next sum received for distribution to record holders of depositary shares.

In the event of a non-cash distribution, the depositary will distribute property to the record holders of depositary shares, unless the depositary determines that it is not feasible to make such a distribution. If this occurs, the depositary may, with our approval, sell the property and distribute the net proceeds from the sale to the holders.

The amounts distributed to holders of depositary shares will be reduced by any amounts required to be withheld by the preferred stock depositary or by us on account of taxes or other governmental charges.

Redemption of Depositary Shares

If the series of preferred stock represented by depositary shares is subject to redemption, then we will give the necessary proceeds to the depositary. The depositary will then redeem the depositary shares using the funds it received from us for the preferred stock. The redemption price per depositary share will be equal to the redemption price payable per share for the applicable series of the preferred stock and any other amounts per share payable with respect to the preferred stock multiplied by the fraction of a share of preferred stock represented by one depositary share. Whenever we redeem shares of preferred stock held by the depositary, the depositary will redeem the depositary shares representing the shares of preferred stock on the same day, provided we have paid in full to the depositary the redemption price of the preferred stock to be redeemed and any accrued and unpaid dividends. If fewer than all the depositary shares of a series are to be redeemed, the depositary shares will be selected by lot or ratably or by any other equitable method as the depositary will decide.

After the date fixed for redemption, the depositary shares called for redemption will no longer be considered outstanding. Therefore, all rights of holders of the depositary shares will cease, except that the holders will still be entitled to receive any cash payable upon the redemption and any money or other property to which the holder was entitled at the time of redemption. To receive this amount or other property, the holders must surrender the depositary receipts evidencing their depositary shares to the preferred stock depositary. Any funds that we deposit with the preferred stock depositary for any depositary shares that the holders fail to redeem will be returned to us after a period of two years from the date we deposit the funds.

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Voting the Preferred Stock

Upon receipt of notice of any meeting at which the holders of preferred stock are entitled to vote, the depositary will notify holders of depositary shares of the upcoming vote and arrange to deliver our voting materials to the holders. The record date for determining holders of depositary shares that are entitled to vote will be the same as the record date for the preferred stock. The materials the holders will receive will describe the matters to be voted on and explain how the holders, on a certain date, may instruct the depositary to vote the shares of preferred stock underlying the depositary shares. For instructions to be valid, the depositary must receive them on or before the date specified. To the extent possible, the depositary will vote the shares as instructed by the holder. We agree to take all reasonable actions that the depositary determines are necessary to enable it to vote as a holder has instructed. The depositary will abstain from voting shares of preferred stock deposited under a deposit agreement if it has not received specific instructions from the holder of the depositary shares representing those shares.

Amendment and Termination of the Deposit Agreement

We may agree with the depositary to amend the deposit agreement and the form of depositary receipt at any time. However, any amendment that materially and adversely alters the rights of the holders of depositary receipts will not be effective unless it has been approved by the holders of at least a majority of the affected depositary shares then outstanding. We will make no amendment that impairs the right of any holder of depositary shares, as described above under Withdrawal of Preferred Stock, to receive shares of preferred stock and any money or other property represented by those depositary shares, except in order to comply with mandatory provisions of applicable law. If an amendment becomes effective, holders are deemed to agree to the amendment and to be bound by the amended deposit agreement if they continue to hold their depositary receipts.

The deposit agreement automatically terminates if a final distribution in respect of the preferred stock has been made to the holders of depositary receipts in connection with our liquidation, dissolution or winding-up. We may also terminate the deposit agreement at any time we wish with at least 60 days prior written notice to the depositary. If we do so, the depositary will give notice of termination to the record holders not less than 30 days before the termination date. Once depositary receipts are surrendered to the depositary, it will send to each holder the number of whole or fractional shares of the series of preferred stock underlying that holder s depositary receipts.

Charges of Depositary and Expenses

We will pay all transfer and other taxes and governmental charges arising solely from the existence of the depositary arrangements. We will pay all charges of the depositary in connection with the initial deposit of the related series of offered preferred stock, the initial issuance of the depositary shares, all withdrawals of shares of the related series of offered preferred stock by holders of the depositary shares and the registration of transfers of title to any depositary shares. However, holders of depositary receipts will pay other taxes and governmental charges and any other charges provided in the deposit agreement to be payable by them.

Limitations on Our Obligations and Liability to Holders of Depositary Receipts

The deposit agreement will expressly limit our obligations and the obligations of the depositary. It will also limit our liability and the liability of the depositary as follows:

we and the depositary are only liable to the holders of depositary receipts for negligence or willful misconduct; and

we and the depositary have no obligation to become involved in any legal or other proceeding related to the depositary receipts or the deposit agreement on your behalf or on behalf of any other party, unless you provide us with satisfactory indemnity.

Resignation and Removal of Depositary

The depositary may resign at any time by notifying us of its election to do so. In addition, we may remove the depositary at any time. Within 60 days after the delivery of the notice of resignation or removal of the depositary, we will appoint a successor depositary.

Reports to Holders

We will deliver all required reports and communications to holders of the offered preferred stock to the depositary, and it will forward those reports and communications to the holders of depositary shares.

ISSUANCE OF COMMON STOCK PURSUANT TO OUR ACQUISITION OF NCONTACT

Effective October 13, 2015, we acquired nContact pursuant to the terms of the Merger Agreement (the Merger Agreement), by and among AtriCure, two wholly-owned subsidiaries of AtriCure, and WRYP Stockholders Services, LLC, solely in its capacity as representative of the stockholders (Representative). As consideration for the merger, we paid upfront consideration of 3,452,152 shares of our common stock and approximately $7.6 million in cash and deposited an additional 304,876 shares of our common stock into an escrow established pursuant to the Merger Agreement for post-closing claims.

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Subject to meeting certain additional performance milestones throughout the five-year period beginning January 1, 2016, as more particularly described in the Merger Agreement, the nContact stockholders will be eligible to receive additional consideration in the form of earn out payments (the Earn-Out). The Earn-Out may be paid in a combination of cash and our common stock. The Merger Agreement provides that the maximum number of shares that may be issued by AtriCure in connection with all of the transactions contemplated by the Merger Agreement, including the Earn-Out, shall not exceed 19.9% of AtriCure s outstanding shares of common stock prior to the acquisition of nContact. This prospectus relates to the resale of the 3,757,028 shares of our common stock previously issued, and up to 1,902,956 additional shares that may be issued pursuant to the Earn-Out by us to the former stockholders of nContact (the selling securityholders) in connection with the Merger Agreement.

SELLING SECURITYHOLDERS

The shares of common stock to be sold pursuant to this prospectus identified in the table below were issued in a private placement to the selling securityholders in connection with the consummation of transactions contemplated by the Merger Agreement described above in Issuance of Common Stock Pursuant to our Acquisition of nContact. When we refer to the selling securityholders in this prospectus, we mean the holders listed in the table below, as well as their permitted transferees, assignees, donees, pledgees and successors in interest.

The Registration Statement of which this prospectus forms a part has been filed pursuant to registration rights granted to the selling securityholders in the Merger Agreement in order to permit the selling securityholders to resell to the public shares of our common stock, as well as any shares of common stock that we may issue or may be issuable by reason of the Earn-Out. We will pay certain expenses of the registration of the selling securityholders shares of our common stock, including SEC filing fees, but the selling securityholders will pay all underwriting discounts and commissions, if any.

Securityholders that received shares pursuant to the Merger Agreement entered into a Lock-Up and Liquidity Agreement. Pursuant to the Lock-Up and Liquidity Agreement and subject to certain exceptions, for a period that ended the 180th day following the closing of the Merger (the Lock-Up Period), the selling securityholders agreed that they would not offer, sell, contract to sell, pledge, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, make any short sale or otherwise transfer, hedge or dispose of any of our shares, enter into any swap or other arrangement that transfers our shares, make any demand for or exercise any right with respect to registration of any of our shares, or publicly announce the intention to do any of the foregoing, without our prior written consent. Notwithstanding the foregoing, AtriCure agreed to use commercially reasonable efforts after the closing to undertake an organized liquidity event that gives selling securityholders the right, during the Lock-Up Period, to sell up to 50% of such selling securityholder s shares received pursuant to the Merger Agreement. The Lock-Up Period does not apply to any of our shares issued as part of any Earn-Outs.

Pursuant to registration rights granted in the Merger Agreement, each selling securityholder must promptly notify us in writing of any changes in the information set forth in the Registration Statement regarding the selling securityholder. We may, by giving two (2) days prior written notice to each selling securityholder, delay or suspend the Registration Statement and require that all selling securityholders immediately cease sales of shares of our common stock pursuant to the Registration Statement, for a period no longer than fourteen (14) calendar days, in the event that: (i) we are involved in any activity, transaction, preparations or negotiations that we desire to keep confidential for business reasons and we in good faith determine that the public disclosure requirements imposed on us pursuant to the Registration Statement would require a disclosure that could cause us imminent and material harm; or (ii) any other event occurs that makes any statement of a material fact in the Registration Statement untrue or requires additions or changes to the Registration Statement; provided, however, that we may only use this right twice

in any twelve-month period.

The table below sets forth certain information known to us with respect to the beneficial ownership of the shares of our common stock held by the selling securityholders as of October 13, 2015. Given that the selling securityholders may sell, transfer or otherwise dispose of all, some or none of the shares of our common stock covered by this prospectus, we cannot determine the number of such shares that will be sold, transferred or otherwise disposed of by the selling securityholders, or the amount or percentage of shares of our common stock that will be held by the selling securityholders upon termination of this offering. See Plan of Distribution. For the purposes of the table below, we assume that the selling securityholders will sell all of their shares of our common stock covered by this prospectus.

In the table below, the percentage of shares beneficially owned is based on 33,123,362 shares of our common stock outstanding as of June 10, 2016. Beneficial ownership is determined under the rules of the SEC and generally includes voting or investment power with respect to securities. The entities named in the table below have sole voting and sole investment power with respect to all shares beneficially owned.

Except as described herein, none of the selling securityholders has had any material relationship with us except with respect to ownership of the shares of common stock.

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	Shares beneficially owned prior to this offering			Shares beneficially owned after offering	
Name and address of beneficial owner	Common stock (1)	Percentage of shares	Shares to be sold in offering	Common stock	Percentage of shares
Intersouth Partners VI, L.P. (2) 102 City Mall Plaza, Suite 200 Durham, NC 27701	1,998,465	6.20%	1,998,465		
Massey Burch Venture Fund II, L.P. (3) 4007 Hillsboro Rd. Suite A Nashville, TN 37215	657,225	2.04%	657,225		
Village Ventures Partners Fund, L.P. (4) 1 Bank Street, 2nd Floor Williamstown, MA 01267	25,969	*	25,969		
Village Ventures Partners Fund A, L.P. (4) 1 Bank Street, 2nd Floor Williamstown, MA 01267	1,874	*	1,874		
Tall Oaks Capital Investments, LLC (5) 315 Old Ivy Way, Suite 301 Charlottesville, VA 22903	79,406	*	79,406		
Finistere-Chicago Partners Fund I L.P. (6) 4365 Executive Drive, Suite 1500 San Diego, CA 92121	393,425	1.22%	393,425		
Finistere-Oceania Partners Fund I L.P. (6) 4365 Executive Drive, Suite 1500 San Diego, CA 92121	108,247	*	108,247		
Hippo Ventures, L.L.C. (7) 3101 Hillsborough St. Raleigh, NC 27607	336,190	1.04%	336,190		
Hippo Ventures II, L.L.C. (7) 3101 Hillsborough St. Raleigh, NC 27607	264,812	*	264,812		
Harbert Venture Partners, LLC (8) 2100 Third Avenue North, Suite 600 Birmingham, AL 35203	309,678	*	309,678		
Harbert Venture Partners II, L.P. (9) 2100 Third Avenue North, Suite 600 Birmingham, AL 35203	436,463	1.35%	436,463		
SVB Financial Group 3005 Tasman Dr. Santa Clara, CA 95054	151	*	151		
ZMV Associates, LLC (10) 114 River Road Scarborough, NY 10510	215,528	*	215,528		
NCON Co-Investor, LLC (9) 2100 Third Avenue North, Suite 600 Birmingham, AL 35203	308,875	1.09%	308,875		

Harbert Venture Partners (Annex Fund), LLC (8) 2100 Third Avenue North, Suite 600 Birmingham, AL 35203	38,902	*	38,902
Excelleration MedTech, LLC (11) 3550 Lakeline Blvd., Suite 170-1520 Leander, TX 78641	367,920	1.14%	367,920
Lakestone Capital, LLC (12) 2626 Glenwood Avenue, Suite 483 Raleigh, NC 27608	17,487	*	17,487
Hercules Technology III, L.P. (13) 400 Hamilton Ave., Suite 310 Palo Alto, CA 94301	11,341	*	11,341
Michael S. Estes PhD 1173 Brown Ave. Lafayette, CA 94549	5,078	*	5,078
John P. Funkhouser 3340 Alleghany Drive Raleigh, NC 27609	50,819	*	50,819
James G. Whayne 3922 Overcup Oak Lane Cary, NC 27519	11,306	*	11,306
Sidney D. Fleischman 1147 Scholastic Circle Durham, NC 27713	20,823	*	20,823

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* denotes less than one percent

1. Includes shares of our common stock over which the selling securityholder has sole voting and dispositive power as well as shares of our common stock held in escrow over which WRYP Stockholders Services, LLC in its capacity as representative of the selling securityholder has sole voting power as follows: Intersouth Partners VI, L.P. 109,157 shares; Massey Burch Venture Fund II, L.P. 35,901 shares; Village Ventures Partners Fund, L.P. 1,417 shares; Village Ventures Partners Fund A, L.P. 107 shares; Tall Oaks Capital Investments, LLC 4,342 shares; Finistere-Chicago Partners Fund I L.P. 21,491 shares; Finistere-Oceania Partners Fund I L.P. 5,917 shares; Hippo Ventures, L.L.C. 18,363 shares; Hippo Ventures II, L.L.C. 14,462; Harbert Venture Partners, LLC 16,917 shares; Harbert Venture Partners II, L.P. 23,842 shares; SVB Financial Group - 12 shares; ZMV Associates, LLC 11,769 shares; NCON Co-Investor, LLC 16,867 shares; Harbert Venture Partners (Annex Fund), LLC 2,121 shares; Excelleration MedTech, LLC 20,097 shares; Lakestone Capital, LLC 953 shares; Hercules Technology III, L.P. - 620 shares; John P. Funkhouser - 279 shares; James G. Whayne - 114 shares; Sidney D. Fleischman - 128 shares. Also includes up to an aggregate of 1,902,956 shares of our common stock that may be issued as Earn-Out as follows: Intersouth Partners VI, L.P. 671,939 shares; Massey Burch Venture Fund II, L.P. 220,935 shares; Village Ventures Partners Fund, L.P. 8,753 shares; Village Ventures Partners Fund A, L.P. 570 shares; Tall Oaks Capital Investments, LLC 26,641 shares; Finistere-Chicago Partners Fund I L.P. 132,256 shares; Finistere-Oceania Partners Fund I L.P. 36,346 shares; Hippo Ventures, L.L.C. 113,036 shares; Hippo Ventures II, L.L.C. 89,059 shares; Harbert Venture Partners, LLC 104,092 shares; Harbert Venture Partners II, L.P. 146,719 shares; ZMV Associates, LLC 72,503 shares; NCON Co-Investor, LLC 103,902 shares; John P. Funkhouser 17,126 shares; James G. Whayne 3,805 shares; Sidney D. Fleischman 7,040 shares; Harbert Venture Partners (Annex Fund), LLC 13,130 shares; Excelleration MedTech, LLC 123,693 shares; Lakestone Capital, LLC 5,899 shares; Hercules Technology III, L.P. 3,805 shares; Michael S. Estes PhD 1,707 shares.
2. The general partner of Intersouth Partners VI, L.P. is Intersouth Associates VI, LLC, the managers of which are Intersouth Advisors, Inc., Dennis Dougherty and Mitch Mumma, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.
3. The general partner of Massey Burch Venture Fund II, L.P. is MB Partners II, L.P., the managers of which are William F. Earthman III and Donald M. Johnston, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her pecuniary interest therein.
4. The general partner of Village Ventures Partners Fund, L.P. and Village Ventures Partners Fund A, L.P. is Village Ventures Capital Partners I, LLC, the managers of which are Village Ventures, Inc., Matthew C. Harris and William Bo S. Peabody, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.
5. The manager of Tall Oaks Capital Investments, LLC is Colin M. Rolph, who may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his pecuniary interest therein.
6. The general partner of Finistere-Chicago Partners Fund I L.P. and Finistere-Oceania Partners Fund I L.P. is Finistere Ventures, LLC, the managers of which are Bruce J. Brumfield, Jr., Jerry Caulder and Aramia Kukutai, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.
7. The manager of Hippo Ventures, L.L.C. and Hippo Ventures II, L.L.C. is Robert Young, who may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his pecuniary interest therein.
8. The manager of Harbert Venture Partners, LLC and Harbert Venture Partners (Annex Fund), LLC is Harbert Venture Partners MM, LLC, the managers of which is HMC-Virginia, Inc. and William W. Brooke, each of

whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.

9. The general partner of Harbert Venture Partners II, L.P., and the manager of NCON Co-Investor, LLC, is Harbert Venture Partners II GP, LLC, the managers of which are HMC-Virginia, Inc. and William W. Brooke, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.
10. The manager of ZMV Associates, LLC is Robert C. Mayer, Jr., who may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his pecuniary interest therein.
11. The manager of Excelleration MedTech, LLC is Robert L. Kay, who may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his pecuniary interest therein.
12. The manager of Lakestone Capital, LLC is Todd A. Robinson, who may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his pecuniary interest therein.
13. The general partner of Hercules Technology III, L.P. is Hercules Technology SBIC Management, LLC, the managers of which are Hercules Technology Growth Capital, Inc., Manuel Henriquez, Mark Harris, Scott Bluestein and Walter Lee, each of whom may be deemed to share voting and investment power with respect to the securities and disclaims beneficial ownership of the securities, except to the extent of his/her/its pecuniary interest therein.

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PLAN OF DISTRIBUTION

We and the selling securityholders may offer the securities covered by this prospectus in any of the following ways (or in any combination) from time to time:

- to or through underwriters or dealers;
- directly to purchasers or to a single purchaser;
- through agents; or
- in at the market offerings, within the meaning of Rule 415(a)(4) of the Securities Act, to or through a market maker or into an existing trading market, on an exchange or otherwise.

In addition, we and any selling securityholder may enter into derivative or other hedging transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If any applicable prospectus supplement indicates, in connection with such a transaction, such third parties may, pursuant to this prospectus and any applicable prospectus supplement, sell securities covered by this prospectus and any applicable prospectus supplement. If so, the third party may use securities borrowed from others to settle such sales and may use securities received from us to close out any related short positions. We and the selling securityholders may also loan or pledge securities covered by this prospectus and any applicable prospectus supplement to third parties, who may sell the loaned securities or, in an event of default in the case of a pledge, sell the pledged securities pursuant to this prospectus and any applicable prospectus supplement.

Any applicable prospectus supplement will set forth the terms of the offering of the securities covered by this prospectus, including:

- the name or names of any underwriters, dealers or agents and the amounts of securities underwritten or purchased by each of them, if any;
- any material relationship with the underwriter and the nature of such relationship, if any;
- the over-allotment options under which underwriters may purchase additional securities, if any;
- the public offering price or purchase price of the securities and the proceeds to us and any discounts, commissions, or concessions or other items constituting compensation allowed, re-allowed or paid to underwriters, dealers or agents, if any;

any securities exchanges on which the securities may be listed, if any; and

the manner for refunding any excess amount paid (including whether interest will be paid).

Any public offering price or purchase price and any discounts, commissions, concessions or other items constituting compensation allowed or re-allowed or paid to underwriters, dealers or agents may be changed from time to time.

The securities may be offered and sold from time to time in one or more transactions, including negotiated transactions, at a fixed price or prices or at varying prices determined at the time of sale. If underwriters are used in the sale of any securities, the securities will be acquired by the underwriters for their own account and may be resold from time to time in one or more transactions described above. The securities may be either offered to the public through underwriting syndicates represented by managing underwriters, or directly by underwriters. Generally, the underwriters obligations to purchase the securities will be subject to certain conditions precedent. The underwriters will be obligated to purchase all of the securities if they purchase any of the securities.

We and the selling securityholders may sell the securities through agents from time to time. If required by applicable law, any applicable prospectus supplement will name any agent involved in the offer or sale of the securities and any commissions we pay to them. Generally, unless otherwise indicated in any applicable prospectus supplement, any agent will be acting on a best efforts basis for the period of its appointment. If a dealer is used in the sale of the securities in respect of which the prospectus is delivered, we or the selling stockholders will sell such securities to the dealer, as principal. The dealer may then resell such securities to the public at varying prices to be determined by such dealer at the time of resale.

We and the selling securityholders may authorize underwriters, dealers or agents to solicit offers by certain purchasers to purchase the securities from us at the public offering price set forth in any applicable prospectus supplement or other prices pursuant to delayed delivery or other contracts providing for payment and delivery on a specified date in the future. Any delayed delivery contracts will be subject only to those conditions set forth in any applicable prospectus supplement, and any applicable prospectus supplement will set forth any commissions we pay for solicitation of these delayed delivery contracts.

Each underwriter, dealer and agent participating in the distribution of any offered securities that are issuable in bearer form will agree that it will not offer, sell, resell or deliver, directly or indirectly, offered securities in bearer form in the United States or to U.S. persons except as otherwise permitted by Treasury Regulations Section 1.163-5(c)(2)(i)(D).

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Offered securities may also be offered and sold, if so indicated in any applicable prospectus supplement, in connection with a remarketing upon their purchase, in accordance with a redemption or repayment pursuant to their terms, or otherwise, by one or more remarketing firms, acting as principals for their own accounts or as agents for us or the selling securityholders. Any remarketing firm will be identified and the terms of its agreements, if any, with us, and its compensation will be described in any applicable prospectus supplement.

We and the selling securityholders may sell equity securities in an offering at the market, as defined in Rule 415 under the Securities Act. A post-effective amendment to this Registration Statement will be filed to identify the underwriter(s) at the time of the take-down for at the market offerings.

Agents, underwriters and other third parties described above may be entitled under relevant underwriting or other agreements to indemnification by us or the selling securityholders against certain civil liabilities under the Securities Act, or to contribution with respect to payments which the agents, underwriters or other third parties may be required to make in respect thereof. Agents, underwriters and such other third parties may be customers of, engage in transactions with, or perform services for us or the selling securityholders in the ordinary course of business.

LEGAL MATTERS

The validity of the securities offered by this prospectus will be passed upon for us by Keating Muething & Klekamp PLL, Cincinnati, Ohio.

EXPERTS

The consolidated financial statements and the related financial statement schedule, incorporated in this prospectus by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2015 and the effectiveness of AtriCure s internal control over financial reporting have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in its reports, which are incorporated by reference herein. Such financial statements and financial statement schedule have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

The audited financial statements of nContact Surgical, Inc. and Subsidiaries as of and for the years ended December 31, 2014 and 2013, included in this prospectus and elsewhere in the registration statement have been so included in reliance upon the report of Grant Thornton LLP, independent certified public accountants, upon the authority of said firm as experts in accounting and auditing.

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FINANCIAL STATEMENTS

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OF

nCONTACT SURGICAL, INC. AND SUBSIDIARIES

INDEX TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

OF

ATRICURE, INC. AND SUBSIDIARIES AND nCONTACT SURGICAL, INC. AND SUBSIDIARIES

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nContact Surgical, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets (unaudited)

September 30	**2015** **$**	**2014** **$**
Assets		
Current assets:		
Cash and cash equivalents	3,911,195	4,235,254
Accounts receivable	1,601,176	1,668,140
Short-term investments, net	4,990,254	826,812
Prepaid expenses	171,097	184,172
Inventory, net	677,307	645,724
Other current assets		7,377
Total current assets	11,351,029	7,567,479
Deposits	7,433	7,433
Long-term deferred financing costs	322,377	
Property and equipment, net	327,131	359,106
Total assets	12,007,970	7,934,018
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	256,379	150,685
Accrued expenses	832,534	724,192
Deferred revenue	277,363	338,055
Current portion of deferred rent	9,183	2,380
Current portion of notes payable		6,688
Total current liabilities	1,375,459	1,222,000
Long-term portion of notes payable and debt	9,766,061	2,803
Warrant liability	465,262	182,488
Total liabilities	11,606,782	1,407,291
Commitments and contingencies (Note 4)		
Stockholders equity:		
Common stock, $0.00001 par value; 20,696,284 shares authorized; 2,307,489 shares and 2,113,218 shares issued and outstanding as of Sept 30, 2015 and 2014, respectively	23	21
Series A convertible preferred stock, $0.00001 par value; 2,755,372 shares designated, issued and outstanding as of Sept. 30, 2015 and 2014 (aggregate liquidation preference of $8,765,291)	8,765,291	8,435,291
Series B convertible preferred stock, $0.00001 par value; 2,619,080 shares designated, issued and outstanding as of Sept. 30, 2015 and 2014 (aggregate	11,578,044	11,128,044

liquidation preference of $11,578,044)		
Series C convertible preferred stock, $0.00001 par value; 2,282,981 shares designated, issued and outstanding as of Sept. 30, 2015 and 2014 (aggregate liquidation preference of $12,518,158)	12,518,158	12,008,158
Series C-1 convertible preferred stock, $0.00001 par value; 1,289,210 shares designated; 1,285,181 shares issued and outstanding as of Sept. 30, 2015 and 2014 (aggregate liquidation preference of $6,643,966)	6,643,966	6,356,868
Series D convertible preferred stock, $0.00001 par value; 4,464,726 shares designated; 4,357,291 shares issued and outstanding as of Sept. 30 2015 and 2014 (aggregate liquidation preference of $21,018,995)	21,018,995	20,044,576
Series D-1 convertible preferred stock, $0.00001 par value; 3,491,620 shares designated; 3,001,937 shares issued and outstanding as of Sept. 30, 2015 and 2014 (aggregate liquidation preference of $12,859,991)	12,836,320	12,139,888
Accumulated deficit	(72,959,609)	(63,586,119)
Total stockholders equity	401,188	6,526,727
Total liabilities and stockholders equity	12,007,970	7,934,018

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nContact Surgical, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations (unaudited)

For the nine months ended September 30	**2015**	**2014**
	$	**$**
Revenue	7,731,763	6,238,382
Cost of sales	1,010,539	886,848
Gross margin	6,721,224	5,351,534
Operating expenses:		
General and administrative	2,821,888	2,104,682
Research and development	586,677	595,950
Quality assurance and regulatory	1,050,196	1,033,582
Medical education	2,033,677	1,689,097
Sales and marketing	3,947,050	3,485,977
Total operating expenses	10,439,488	8,909,288
Operating loss	(3,718,264)	(3,557,754)
Other income (expense):		
Interest (expense) income	(915,355)	5,568
Change in fair value of preferred stock warrants	46,447	19,519
Net loss	(4,587,172)	(3,532,667)

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nContact Surgical, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (unaudited)

For the nine months ended September 30	**2015** **$**	**2014** **$**
Cash flows from operating activities:		
Net loss	(4,587,172)	(3,532,667)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	138,060	131,364
Disposal of fixed assets	46,164	5,523
Change in fair value of preferred stock warrants	(46,447)	(19,519)
Stock-based compensation	48,812	41,163
Amortization of deferred financing costs	124,657	
Amortization of debt discount	99,507	
Changes in operating assets and liabilities:		
Accounts receivable	(530,633)	(19,160)
Prepaid expenses	(41,493)	1,553
Deposits and other assets	10,707	(3,767)
Inventory, net	98,972	61,272
Accounts payable	94,050	(203,349)
Accrued expenses	438,511	370,240
Deferred revenue	(56,516)	338,055
Deferred rent	1,147	(7,138)
Net cash used in operating activities	(4,161,674)	(2,836,430)
Cash flows from investing activities:		
Purchase of property and equipment	(191,798)	(215,731)
Proceeds from sale of equipment	12,000	
Purchases of short-term investments	(5,340,254)	
Sales and maturities of short-term investments	350,000	3,667,952
Net cash (used in) provided by investing activities	(5,170,052)	3,452,221
Cash flows from financing activities:		
Proceeds from sale of common stock	71,609	5,461
Sale of preferred stock		40,475
Payments on notes payable	(7,845)	(4,849)
Net cash provided by financing activities	63,764	41,087
Net (decrease) increase in cash and cash equivalents	(9,267,962)	656,878
Cash and cash equivalents, beginning of period	13,179,157	3,578,376
Cash and cash equivalents, end of period	3,911,195	4,235,254

Supplemental disclosure of cash flow information	**Cash paid for interest**	704,329	357
Warrant liability		46,447	19,519
Non-cash accretion of preferred stock		12,912	12,912

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nContact Surgical, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (unaudited)

1 Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

nContact Surgical, Inc. and Subsidiaries (the Company) is a Delaware corporation operating in Morrisville, North Carolina. The Company was incorporated on July 15, 2004, with a focus on providing cardiac tissue coagulation devices used during surgical procedures. The Company has sales of its product in the United States and Europe.

On March 5, 2014, the Company entered into a Membership Interest Purchase Agreement with Paul Funkhouser for the purchase of 100% of the membership interests of Shared Healthcare Metrics, LLC for a nominal amount. The Board of Directors approved this purchase agreement by written consent as it deemed it to be in the best interest of the Company.

Since inception, the Company has devoted substantially all of its efforts towards developing and marketing its technology. For the period ended September 30, 2015 and 2014, the Company has consolidated negative cash flows from operations of $4,161,674 and $2,836,430 respectively and a consolidated loss from operations of $4,587,172 and $3,532,667. As of September 30, 2015 and 2014, the Company has a consolidated accumulated deficit of $72,959,609 and $63,586,119 respectively. Management s plans include increasing sales, continued development and marketing of its product and diligent management of expenses. In November 2014, the Company entered into a Loan and Security agreement for $20,000,000 to provide additional capital for the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Shared Healthcare Metrics, LLC. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the allowance for doubtful accounts, deferred revenue, inventory allowances, deferred tax asset valuation allowances, valuation of stock warrant liabilities and stock-based compensation expense. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less from the balance sheet date to be cash equivalents.

Short-term Investments

The Company considers all investments with a maturity of more than three months but less than a year from the balance sheet date as short-term investments. Short-term investments consist of government and corporate bonds. The

investments are classified as trading securities, and are carried at cost plus unrealized gain or loss which approximates fair value. Unrealized holding gains and losses are included in earnings. For purpose of determining realized gains and losses, the cost of securities sold is based on specific identification.

Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents, short-term investments and accounts receivables. Cash deposits are held in federally insured financial institutions in the United States of America. However, at times, deposits have exceeded the amount insured by the Federal Deposit Insurance Corporation.

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Accounts Receivable

Accounts receivable, which subject the Company to credit risk, are stated at net realizable value. Sales are made to hospitals located throughout the United States and Europe. Accounts receivable are typically due within 30 days for domestic customers and due within 60-90 days for foreign customers. Amounts outstanding for longer than the payment terms are considered past due. At each balance sheet date, the Company assesses its need for an allowance for potential losses in the collection of its accounts receivable. Estimated losses are based on experience and management s opinion of the current status of existing receivables. At September 30, 2015 and 2014, the Company determined that no allowance was necessary.

Inventory

Inventory is comprised of parts used in the Company s coagulation devices or sold as an accessory to the devices. Inventory is valued at lower of cost or market and is accounted for on a first-in, first-out (FIFO) basis. The evaluation of inventory obsolescence involves an approach that incorporates both recent historical information and management estimates of trends. As of September 30, 2015 and 2014, the Company maintained reserves of $25,000 to reduce its inventory to its net realizable value.

Deferred Financing Costs

Deferred financing costs represent the direct costs of entering into the Company s Loan and Security Agreement in November 2014 detailed further in Note 5. These costs are amortized as interest expense using the effective interest method over the term of the loan and are presented on the balance sheet, net of accumulated amortization.

Property and Equipment

Property and equipment consists primarily of laboratory, production and computer equipment, which are recorded at cost and depreciated using the straight-line method over their estimated useful lives, ranging from three to ten years. Depreciation expense for the periods ended September 30, 2015 and 2014, was $138,060 and $131,364, respectively.

Repairs and maintenance costs are expensed as incurred.

Impairment of Long-lived Assets

The Company evaluates the recoverability of its property and equipment on an annual basis or more frequently if certain events occur that indicate impairment. The Company assesses long-lived assets for impairment by comparing net book value of such assets to the estimated future undiscounted cash flows attributable to such assets. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of these assets in relation to the operating performance of these assets and future undiscounted cash flows expected to result from the use of these assets. No such impairments have been recognized during the periods ended September 30, 2015 and 2014.

Revenue Recognition

The Company enters into sales arrangements that may provide for multiple deliverables to a customer. Sales of medical equipment primarily consists of disposable surgical ablation devices. Generators and other capital equipment (such as the Company s monitors, and laptops) are loaned at no cost to direct customers that use the Company s disposable products. Depreciation of such assets is included in cost of sales. The Company identifies all goods and/or services that are to be delivered separately under a sales arrangement and allocates revenue to each deliverable based

on relative fair values. Fair values are generally established based on the prices charged when sold separately by the Company. In general, revenues are separated between medical equipment, and the loaning of the required generators and laptops. The allocated revenue for each deliverable is then recognized ratably based on relative fair values of the components of the sale. Revenue from the sales of the disposal devices is recognized when a sale is made to a customer, in accordance with shipping terms, which is generally upon the shipment of goods. Shipping and handling costs are included within cost of sales in the statements of operations. Shipping costs billed to customers are included in revenues.

Additionally, the Company provides customers with a generator on loan and defers a portion of the revenue from the related generators based on the relative fair value of the equipment lease. The generator lease agreements typically are for a one year period, after which, the lease will auto-renew for an additional period of one year or until the Customer returns the generator. As the lease period of the generator is not a fixed term, the Company utilizes an assumption regarding the average number of auto renewals based on historical data. This assumption is then used to estimate the fair value of the loaned generator based on the estimated lease period. This deferred lease revenue is recognized ratably, on a straight-line basis, over the abovementioned estimated lease period.

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Revenues and accounts receivable from individual customers that are equal to or greater than 10% of revenues or accounts receivable are as follows:

	September 30, 2015		September 30, 2014	
	Percent Revenue	Percent Accounts Receivable	Percent Revenue	Percent Accounts Receivable
Customer A	*	11%	*	*%
Customer B	*		*	11%
Customer C	*		*	11%

* Less than 10%

Research and Development

The Company expenses research and development costs as incurred. These costs primarily consist of salaries, consulting fees, development materials and supplies directly involved in the research and development of new technology. Research and development costs totaled $586,677 and $595,950 for the periods ended September 30, 2015 and 2014, respectively, and are shown as research and development expenses in the accompanying statements of operations.

Sales Tax

Sales taxes and other taxes collected from customers and remitted to governmental authorities are presented on a net basis and, as such, are excluded from revenues.

Stock-based Compensation

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, which is the vesting period. Stock-based compensation costs for stock options are recognized on a straight-line basis.

The fair value of options granted is estimated on the date of grant using the Black-Scholes-Merton option pricing model based on the assumptions in the table below.

September 30	2015	2014
Expected dividend yield	0.00%	0.00%
Weighted average expected stock price volatility	82.9%	91.5%
Range of expected stock price volatility	29% to 172%	29% to 206%
Weighted average risk-free interest rate	0.70%	0.40%
Range of risk-free interest rate	0.70%	0.40%
Expected life of options	2.5 years	2 years

The expected life of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. Volatility is based on the historical volatility of several public entities that are similar to the Company, as the Company does not have sufficient historical transactions of its own shares on which to base expected volatility.

Restricted Stock

As needed, the Company will grant restricted common stock to executives and consultants. These shares vest over specified time periods. With these agreements, the Company has the option to repurchase any unvested shares upon termination of the executive or consulting agreement.

An executive of the Company purchased 35,000 shares of restricted common stock during 2006 at $0.20 per share. As of the purchase date of the shares, 50% of the shares vested immediately, with the remaining to vest ratably over 32 months. As of September 30, 2014, all shares purchased were fully vested. This executive also purchased 29,000 shares of restricted common stock during 2007 at $0.20 per share. The shares vest ratably over 28 months. As of September 30, 2014, all shares purchased were fully vested. In 2008,

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this executive purchased 160,469 shares of restricted common stock that were granted in 2007 at $0.21 per share. As of the purchase date, approximately 96,300 shares vested immediately with the rest to vest upon completion of milestones established in Series C-1. As of September 30, 2015, none of these milestones had been achieved. In 2011, this executive purchased 343,829 shares of restricted common stock that were granted as stock options in 2010 at $0.24 per share, then modified and exercised early into restricted common stock. One-fourth of the shares will vest one year after vesting commencement and the remainder will vest at the rate of 1/48 at the end of each month thereafter. As of September 30, 2015 all shares were vested, at September 30, 2014 322,340 shares were vested.

Consultants of the Company purchased 75,000 shares of restricted common stock during 2007 at $0.21 per share. As of September 30, 2014, all shares purchased were fully vested. In 2008, a consultant purchased 10,000 shares of restricted common stock at $0.371 per share. As of September 30, 2014, all shares purchased were fully vested. In 2010, a consultant purchased 60,000 shares of restricted common stock at $0.29 per share. As of September 30, 2014, all shares purchased were fully vested.

Quality Assurance and Regulatory

Quality assurance and regulatory costs include direct costs associated with personnel performing quality control testing, including salary and benefit expenses. This function includes ongoing quality control testing, regulatory and compliance audits, verification and sterilization testing of products under development, and ongoing costs associated with clinical studies support. Quality assurance and regulatory costs totaled $1,050,196 and $1,033,582 for the periods ended September 30, 2015 and 2014, respectively, and are shown as quality assurance and regulatory expenses in the accompanying consolidated statements of operations.

Medical Education

Medical education costs include direct costs associated with personnel performing training and coaching of physicians on the proper use of the Company s technology. These costs consist primarily of salaries and benefits, travel and physician consulting fees. Medical education costs totaled $2,033,677 and $1,689,097 for the periods ended September 30, 2015 and 2014, respectively, and are shown as medical education expenses in the accompanying consolidated statements of operations.

Sales and Marketing

Sales and marketing costs include direct costs associated with personnel performing sales activities of the product and also marketing of the product and procedure through avenues like tradeshows. Sales and marketing also includes the costs that Shared Healthcare Metrics, LLC incurred. These costs totaled $337,420 and $248,148 for the periods ended September 30, 2015 and September 30, 2014 respectively. Sales and marketing costs totaled $3,947,050 and $3,485,977 for the periods ended September 30, 2015 and 2014, respectively, and are shown as sales and marketing expenses in the accompanying statements of operations.

Income Taxes

The Company accounts for income taxes using an asset and liability method, which requires the recognition of deferred tax assets or liabilities for the temporary differences between financial reporting and tax bases of the Company s assets and liabilities, and for tax carryforwards at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. The Company has recorded a full valuation allowance

against its net deferred tax assets as it is more likely than not that the benefit of the deferred tax assets will not be recognized in future periods.

3 Stockholders Equity and Convertible Preferred Stock

At September 30, 2015, the Company was authorized to issue 37,599,273 shares of capital stock ($0.00001 par value), of which 20,696,284 shall be designated Common Stock and 16,902,989 shall be designated Preferred Stock (2,755,372 shares of Series A Preferred Stock, 2,619,080 shares of Series B Preferred Stock, 2,282,981 shares of Series C Preferred Stock, 1,289,210 shares of Series C-1 Preferred Stock, 4,464,726 shares of Series D Preferred Stock and 3,491,620 shares of Series D-1 Preferred Stock).

On January 31, 2014, certain members of the Company s management team purchased a total of 10,871 shares of Series D Convertible Preferred Stock for $3.7232 per share for gross proceeds of $40,475 as approved by the Board of Directors on January 27, 2014.

The Preferred Stock was originally recorded at the net proceeds received by the Company at issuance. The difference between the net proceeds and the total redemption price is being accreted using the straight-line method (which approximates the amount that would be calculated under the effective interest method) over the period from issuance until the redemption date. As of September 30, 2015 cumulative accrued dividends were $19,701,876.

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4 Commitments and Contingencies

Lease Agreements. The Company leases certain office, manufacturing and warehouse facilities and equipment under noncancelable operating leases that expire at various terms through 2019. During 2015, the company entered into a month to month lease for a furnished corporate apartment, the rent expense for the period ended September 30, 2015 is $20,487.

Purchase Agreements. The Company enters into standard purchase agreements with certain vendors in the ordinary course of business. Outstanding commitments at September 30, 2015 and 2014 were not significant.

Legal. The Company is not currently party to any material pending or threatened litigation. The Company may, from time to time, become a party to legal proceedings.

5 Debt

On November 10, 2014, the Company signed a Loan and Security Agreement with Hercules Technology Growth Capital, Inc for a $20,000,000 term loan. The first tranche of $10,000,000 was funded on the closing date. The loan has an interest only period for the first twenty-one months followed by equal installments of principal and interest. The last payment is a balloon payment on the maturity date of November 1, 2018. The rate of interest is the greater of 9.25% or 9.25% plus prime minus 5.5%. The loan is collateralized by any and all properties, rights and assets of the Company.

Upon meeting performance milestones, the Company can access two additional tranches of $5,000,000 each. The second tranche milestone is the achievement of not less than 85% of projected conservative revenues for the six months ended June 30, 2015. The second tranche is available from July 5, 2015 through August 15, 2015. The third tranche of $5,000,000 is available from April 5, 2016 through May 15, 2016 if the Company meets revenue milestones of not less than 85% of Conservative Revenue Projections for the twelve months ended March 31, 2016. First Amendment to Security and Loan Agreement, dated August 8, 2015 modified the second tranche to eliminate milestones and be available for October 5, 2015 through December 15, 2015. Additionally, the third tranche milestones were eliminated and the tranche is available from June 15, 2016 to August 15, 2016. Each of the tranches are available upon review and approval by Hercules.

In connection with this Agreement, the Company issued 201,440 shares of Series D-1 Preferred Stock warrants with an exercise price of $3.7232 per share which were recorded for $333,445 based on the fair value of the warrants at the grant date. The holders of the warrants have the option to exercise the warrants for Series D-1 Stock, which is mandatorily redeemable for common stock if certain conditions are met. Accordingly, the initial fair value of the warrants was recorded as an accrued warrant liability on the consolidated balance sheets with a debt discount recorded offsetting the warrant liability.

In connection with the Note and Warrant Financing completed on February 10, June 4, and August 16, 2010, the Company issued 107,435 warrants, which granted investors the right to purchase shares of the capital stock into which the Notes converted. The Notes were converted into Series D Preferred Shares at $3.7232 per share on October 20, 2010 and November 5, 2010, for $4,154,081, including accrued and unpaid interest. The warrants are exercisable immediately and expire on May 1, 2017. All warrants remain outstanding as of September 30, 2015.

The warrants are marked to market at the end of the reporting period using the Black-Scholes valuation model. At September 30, 2015 and 2014, all outstanding warrants were adjusted to the fair value of $465,262 and $182,488 respectively as determined by the Company, resulting in a gain of $46,447 and $19,519 for the periods ending

September 2015 and 2014 respectively, which has been reflected in Change in fair value of preferred stock warrants on the consolidated statement of operations. If the Company borrows on the third tranche, an additional warrant of 67,147 shares of Series D-1 Preferred Stock warrants with an exercise price of $3.7232, or the most recent equity round pricing will be issued.

6 Line of Credit

On July 17, 2009, the Company signed a Loan and Security Agreement with a commercial bank for a revolving line of credit in the amount of $500,000. As of September 30, 2014 the Company has not drawn any amounts on this line of credit. The line matures on July 29, 2015 and allows for the Company to borrow up to 80% of eligible accounts receivable at an interest rate of prime plus 1.5%, with a minimum rate of 5.5%. The line is collateralized by any and all properties, rights and assets of the Company. In connection with this revolving line of credit, the Company issued 4,029 shares of Series C-1 Preferred Stock warrants with an exercise price of $3.7232 per share which were recorded for $13,166 based on the fair value of the warrants.

In connection with the Loan and Security Agreement, the Company is required to maintain all banking relationships and has provided a blanket lien on all assets including intellectual property. Additionally, the Company must meet monthly and quarterly covenants as set forth by the Bank. The Bank and the Company agreed to Amendments and Forbearance agreements whereby the bank has provided forbearance for covenants that have been defaulted and amendments to covenants. Previous agreements are as follows: First Amendment and Forbearance to the Loan and Security Agreement dated April 26, 2010, Second Amendment dated September 17,

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2010, Third Amendment dated March 22, 2011, and Fourth Amendment dated July 25, 2011, and the Fifth Amendment and Default Waiver on May 22, 2012, and the Sixth Amendment and Default Waiver on February 26, 2013. In October 2014, the Company terminated the Loan and Security Agreement. At the time of the termination the Company had no outstanding draws against the line of credit.

7 Employee Benefit Plan

Effective January 5, 2006, the Company began a 401(k) profit sharing plan, which allows eligible employees to defer up to 100% of their compensation, up to the applicable limit. The Company, at its discretion, may make matching contributions. However, no matching contributions were made during the nine month periods ended September 30, 2015 or 2014.

8 Inventory, Net

Inventories consist of the following at Sept 30:

	2015 $	2014 $
Raw materials	343,070	392,238
Work in process	19,060	19,466
Finished goods	340,177	259,020
Less reserve	(25,000)	(25,000)
Total inventory, net	677,307	645,724

9 Notes Payable

In March 2011, the Company entered into a note payable for $34,429 with a financial institution in order to purchase a vehicle. The note payable requires monthly payments of principal and interest totaling $578 payable per month through February 2016. The interest rate for the note payable is fixed at 3.9% for a period of five years. On March 19, 2015 the Company sold the vehicle for $12,000 and paid off the remaining balance on the Note.

10 Stock-based Compensation

On May 25, 2005, the Company adopted the 2005 Stock Plan (the Plan), as amended during 2008, 2010, 2013, and 2015 to increase the number of authorized shares. The Plan provides for the granting of up to 3,917,104 stock options to employees, directors and consultants of the Company. On April 1, 2015 the Board of Directors approved the 6th Amendment to the Certificate of Incorporation, which increased shares allowed for Common Stock. The Board of Directors recommended and Stockholders consented to an amendment and increase to the 2005 Stock Plan of 720,000 additional shares. The Board of Directors shall determine the exercise price, term and dates of the exercise of all options at their grant date. Absent a public market price for the Company s common stock, the Board of Directors, based on an independent valuation and other factors, will determine the estimated fair market value of the common stock. The Company issues new shares of common stock upon exercise of stock options. Under the Company s stock option plan, options become vested over four years and expire not more than 10 years after the date of grant.

The Company recognizes expense related to the fair value of the stock-based compensation awards, including employee stock options.

Compensation cost for stock-based employee compensation was $48,812 and $41,163 for the nine month periods ended September 30, 2015 and 2014, respectively.

11 Fair Value Measurements

ASC 820, Fair Value Measurements and Disclosures, establishes a framework for measuring fair value. That framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

That hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

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Level 2 Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs derived principally from/corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Changes in economic conditions or valuation techniques may require the transfer of financial instruments from one fair value to another. In such instances, the transfer is reported at the beginning of the reporting period. For the nine months periods ended September 30, 2015 and 2014, there were no transfers in and out of Level 1, 2, or 3.

The following table sets presents the Company s investments, within the fair value hierarchy, as of September 30, 2015 and 2014. The Company s preferred stock warrants were measured based on unobservable inputs, and thus is considered a Level 3 financial instrument. The Company analyzes financial instruments with features of both liabilities and equity under ASC 480, *Distinguishing Liabilities from Equity*.

The following table sets presents the Company s investments, within the fair value hierarchy, as of September 30, 2015.

	Level 1 $	Level 2 $	Level 3 $	Total $
Assets:				
Money Market Funds		3,316,432		3,316,432
Corporate Bonds		4,990,254		4,990,254
Liabilities:				
Warrant liability			465,262	465,262

The following table sets presents the Company s investments, within the fair value hierarchy, as of September 30, 2014.

	Level 1 $	Level 2 $	Level 3 $	Total $

Assets:			
Money Market Funds	3,541,675		3,541,675
Corporate Bonds	826,812		826,812
Liabilities:			
Warrant liability		182,488	182,488

12 Related-party Transactions

The Company entered into a Membership Interest Purchase Agreement on March 5, 2014 for the purchase of 100% of the membership interests of Shared Healthcare Metrics, LLC. The Board of Directors approved this purchase agreement by written consent as it deemed it to be in the best interest of the Company.

On January 31, 2014, certain members of the Company s management team purchased a total of 10,871 shares of Series D-1 Convertible Preferred Stock for $3.7232 per share for gross proceeds of $40,475 as approved by the Board of Directors on January 27, 2014.

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13 Subsequent Events

On October 4, 2015, the Company entered into a definitive agreement to sell the Company to AtriCure, Inc. Upfront consideration of approximately $8 million in cash and 3.7 million shares of AtriCure, Inc. common stock, and is subject to working capital and other customary adjustments. Subject to meeting certain additional milestones throughout the five year period beginning January 1, 2016 the Company will be eligible to receive additional consideration in the form of earn out payments. Earn out payments may be paid in a combination of cash and additional AtriCure, Inc. common stock.

The Company evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through June 17, 2016, the date the financial statements were available to be issued. All subsequent events requiring recognition and disclosure have been incorporated into these financial statements.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of nContact Surgical, Inc. and Subsidiaries:

We have audited the accompanying financial statements of **nContact Surgical, Inc. and Subsidiaries** (a Delaware corporation) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related statements of operations, changes in stockholders equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management s responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor s responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of nContact Surgical, Inc. and Subsidiaries as of December 31, 2014, and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Raleigh, North Carolina

July 13, 2015

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nContact Surgical, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31	2014 $	2013 $
Assets		
Current assets:		
Cash and cash equivalents	13,179,157	3,578,376
Accounts receivable	1,070,543	1,648,980
Short-term investments, net		4,494,764
Prepaid expenses	129,604	180,405
Inventory, net	776,279	706,996
Other current assets	10,707	8,930
Total current assets	15,166,290	10,618,451
Deposits	7,433	7,433
Long-term deferred financing costs	447,034	
Property and equipment, net	331,557	280,262
	15,952,314	10,906,146
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	162,329	354,034
Accrued expenses	394,023	353,952
Deferred revenue	333,879	
Current portion of deferred rent	8,036	9,518
Current portion of notes payable	6,754	6,496
Total current liabilities	905,021	724,000
Long-term portion of notes payable and debt	9,667,645	7,844
Warrant liability	511,709	202,007
Total liabilities	11,084,375	933,851
Commitments and contingencies (Note 5)		
Stockholders equity:		
Common stock, $0.00001 par value; 20,696,284 shares authorized; 2,113,218 shares and 2,094,385 shares issued and outstanding as of December 31, 2014 and 2013, respectively	21	21
Series A convertible preferred stock, $0.00001 par value; 2,755,372 shares designated, issued and outstanding as of December 31, 2014 and 2013 (aggregate liquidation preference of $8,517,791)	8,517,792	8,187,792
Series B convertible preferred stock, $0.00001 par value; 2,619,080 shares designated, issued and outstanding as of December 31, 2014 and 2013 (aggregate	11,240,544	10,790,544

liquidation preference of $11,240,544)		
Series C convertible preferred stock, $0.00001 par value; 2,282,981 shares designated, issued and outstanding as of December 31, 2014 and 2013 (aggregate liquidation preference of $12,135,658)	12,135,658	11,625,658
Series C-1 convertible preferred stock, $0.00001 par value; 1,289,210 shares designated; 1,285,181 shares issued and outstanding as of December 31, 2014 and 2013 (aggregate liquidation preference of $6,428,643)	6,428,643	6,141,543
Series D convertible preferred stock, $0.00001 par value; 4,464,726 shares designated; 4,357,291 shares issued and outstanding as of December 31, 2014 and 2013 (aggregate liquidation preference of $20,281,245)	20,288,957	19,315,573
Series D-1 convertible preferred stock, $0.00001 par value; 3,491,620 shares designated; 3,001,937 shares and 2,991,066 shares issued and outstanding as of December 31, 2014 and 2013 (aggregate liquidation preference of $12,331,211	12,320,451	11,583,747
Accumulated deficit	(66,064,127)	(57,672,583)
Total stockholders equity	4,867,939	9,972,295
	15,952,314	10,906,146

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nContact Surgical, Inc. and Subsidiaries

Consolidated Statements of Operations

For the years ended December 31	2014 $	2013 $
Revenue	8,190,868	8,370,610
Cost of sales	1,268,456	1,082,254
Gross margin	6,922,412	7,288,356
Operating expenses:		
General and administrative	2,873,353	2,406,866
Research and development	751,832	720,796
Quality assurance and regulatory	1,302,930	1,064,463
Medical education	2,357,027	2,056,496
Sales and marketing	4,767,636	4,140,082
Total operating expenses	12,052,778	10,388,703
Operating loss	(5,130,366)	(3,100,347)
Other income (expense):		
Interest (expense) income	(140,410)	32,336
Other income Insurance proceeds		223,836
Change in fair value of preferred stock warrants	23,743	(32,008)
Net loss	(5,247,033)	(2,876,183)

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nContact Surgical, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

	Preferred Stock									
	Series B		Series C		Series C-1		Series D		Series D	
ount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	A
$		$		$		$		$		
7,792	2,619,080	10,340,544	2,282,981	11,115,658	1,285,181	5,854,444	4,338,759	18,260,894		
							18,532	68,998	2,991,066	1
0,000		450,000		510,000		287,099		973,039		
								12,642		
7,792	2,619,080	10,790,544	2,282,981	11,625,658	1,285,181	6,141,543	4,357,291	19,315,573	2,991,066	1
									10,871	
0,000		450,000		510,000		287,100		973,384		
7,792	2,619,080	11,240,544	2,282,981	12,135,658	1,285,181	6,428,643	4,357,291	20,288,957	3,001,937	1

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nContact Surgical, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

For the years ended December 31	2014 $	2013 $
Cash flows from operating activities:		
Net loss	(5,247,033)	(2,876,183)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	178,968	150,323
Disposal of fixed assets	10,986	62,221
Loss on disposal	(5,523)	
Bridge note interest		19,623
Bridge note interest, cancellation		(41,905)
Change in fair value of preferred stock warrants	(23,743)	32,008
Stock-based compensation	97,711	72,639
Amortization of deferred financing costs	12,466	
Changes in operating assets and liabilities:		
Accounts receivable	578,437	(497,065)
Prepaid expenses	50,801	(120,952)
Deposits and other assets	(1,777)	42,852
Inventory, net	(69,283)	(96,224)
Accounts payable	(191,705)	114,520
Accrued expenses	40,071	(123,277)
Deferred revenue	333,879	
Deferred rent	(1,482)	(7,134)
Net cash used in operating activities	(4,237,227)	(3,268,554)
Cash flows from investing activities:		
Purchase of property and equipment	(235,726)	(224,194)
Net purchases, renewals, and maturities of short-term investments		(5,150,195)
Sales of short-term investments	4,494,764	655,431
Net cash provided by (used in) investing activities	4,259,038	(4,718,958)
Cash flows from financing activities:		
Proceeds from bridge notes		3,000,000
Proceeds from sale of common stock	4,491	16,049
Sale of preferred stock, net of issuance costs	40,475	7,694,104
Payments on notes payable	(6,496)	(6,248)
Proceeds from debt financing	10,000,000	
Payment of deferred financing costs	(459,500)	
Net cash provided by financing activities	9,578,970	10,703,905

Net increase in cash and cash equivalents		9,600,781	2,716,393
Cash and cash equivalents, beginning of year		3,578,376	861,983
Cash and cash equivalents, end of year		13,179,157	3,578,376
Supplemental disclosure of cash flow information	**Cash paid for interest**	54,402	779
Warrant liability		333,445	
Non-cash conversion of long term debt to equity			3,433,751
Non-cash accretion of preferred stock		25,823	27,706

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nContact Surgical, Inc. and Subsidiaries

Notes to consolidated financial statements

1 Organization and Continuing Operations

nContact Surgical, Inc. and Subsidiaries (the Company) is a Delaware corporation operating in Morrisville, North Carolina. The Company was incorporated on July 15, 2004, with a focus on providing cardiac tissue coagulation devices used during surgical procedures. The Company has sales of its product in the United States and Europe.

On March 5, 2014, the Company entered into a Membership Interest Purchase Agreement with Paul Funkhouser for the purchase of 100% of the membership interests of Shared Healthcare Metrics, LLC for a nominal amount. The Board of Directors approved this purchase agreement by written consent as it deemed it to be in the best interest of the Company.

Since inception, the Company has devoted substantially all of its efforts towards developing and marketing its technology. For the year ended December 31, 2014, the Company has consolidated negative cash flows from operations of $4,237,227 and a consolidated loss from operations of $5,247,033. As of December 31, 2014, the Company has a consolidated accumulated deficit of $66,064,127. Management s plans include increasing sales, continued development and marketing of its product and diligent management of expenses. In 2014, the Company entered into a Loan and Security agreement for $20,000,000 to provide additional capital for the company. In 2013, the Company raised additional funding from current and new investors in order to continue to execute its business plan until such time the Company can generate operating revenue in excess of operating expenditures. The financial statements presented herein do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Shared Healthcare Metrics, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

2 Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the allowance for doubtful accounts, deferred revenue, inventory allowances, deferred tax asset valuation allowances, valuation of stock warrant liabilities and stock-based compensation expense. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less from the balance sheet date to be cash equivalents.

Short-term Investments

The Company considers all investments with a maturity of more than three months but less than a year from the balance sheet date as short term investments. Short-term investments consist of government and corporate bonds. The investments are classified as trading securities, and are carried at cost plus unrealized gain or loss which approximates fair value. Unrealized holding gains and losses are included in earnings. For purpose of determining realized gains and losses, the cost of securities sold is based on specific identification.

Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents, short-term investments and accounts receivables. Cash deposits are held in federally insured financial institutions in the United States of America. However, at times, deposits have exceeded the amount insured by the Federal Deposit Insurance Corporation.

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Accounts Receivable

Accounts receivable, which subject the Company to credit risk, are stated at net realizable value. Sales are made to hospitals located throughout the United States and Europe. Accounts receivable are typically due within 30 days for domestic customers and due within 60-90 days for foreign customers. Amounts outstanding for longer than the payment terms are considered past due. At each balance sheet date, the Company assesses its need for an allowance for potential losses in the collection of its accounts receivable. Estimated losses are based on experience and management s opinion of the current status of existing receivables. For the years ended December 31, 2014 and 2013, the Company determined that no allowance was necessary.

Inventory

Inventory is comprised of parts used in the Company s coagulation devices or sold as an accessory to the devices. Inventory is valued at lower of cost or market and is accounted for on a first-in, first-out (FIFO) basis. The evaluation of inventory obsolescence involves an approach that incorporates both recent historical information and management estimates of trends. As of December 31, 2014 and 2013, the Company maintained reserves of $25,000 to reduce its inventory to net realizable value.

Deferred Financing Costs

Deferred financing costs and represent the direct costs of entering into the Company s Loan and Security Agreement in November 2014 detailed further in Note 9. These costs are amortized as interest expense using the effective interest method over the term of the loan and are presented on the balance sheet, net of accumulated amortization,

Property and Equipment

Property and equipment consists primarily of laboratory, production and computer equipment, which are recorded at cost and depreciated using the straight-line method over their estimated useful lives, ranging from three to ten years.

Repairs and maintenance costs are expensed as incurred.

Revenue Recognition

The Company enters into sales arrangements that may provide for multiple deliverables to a customer. Sales of medical equipment primarily consists of disposable surgical ablation devices. Generators and other capital equipment (such as the Company s monitors, and laptops) are loaned at no cost to direct customers that use the Company s disposable products. Depreciation of such assets is included in cost of revenue. The Company identifies all goods and/or services that are to be delivered separately under a sales arrangement and allocates revenue to each deliverable based on relative fair values. Fair values are generally established based on the prices charged when sold separately by the Company. In general, revenues are separated between medical equipment, and the loaning of the required generators and laptops. The allocated revenue for each deliverable is then recognized ratably based on relative fair values of the components of the sale. Revenue from the sales of the disposal devices is recognized when a sale is made to a customer, in accordance with shipping terms, which is generally upon the shipment of goods. Shipping and handling costs are included within cost of sales in the statements of operations. Shipping costs billed to customers are included in revenues.

Additionally, the Company provides customers with a generator on loan and defers a portion of the revenue from the related generators based on the relative fair value of the equipment lease. The generator lease agreements typically are

for a one year period, after which, the lease will auto-renew for an additional period of one year or until the Customer returns the generator. As the lease period of the generator is not a fixed term, the Company utilizes an assumption regarding the average number of auto renewals based on historical data. This assumption is then used to estimate the fair value of the loaned generator based on the estimated lease period. This deferred lease revenue is recognized ratably, on a straight-line basis, over the abovementioned estimated lease period.

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Revenues and accounts receivable from individual customers that are equal to or greater than 10% of revenues or accounts receivable are as follows:

	2014		2013	
	Percent Revenue	Percent Accounts Receivable	Percent Revenue	Percent Accounts Receivable
Customer A	*	*	*	11%
Customer B	*	*	*	11%
Customer C	*	*	*	11%
Customer D	*	*	*	11%
Customer E	*	11%	*	*

* Less than 10%

Sales Tax

Sales taxes and other taxes collected from customers and remitted to governmental authorities are presented on a net basis and, as such, are excluded from revenues.

Stock-based Compensation

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, which is the vesting period. Stock-based compensation costs for stock options are recognized on a straight-line basis.

The fair value of options granted is estimated on the date of grant using the Black-Scholes-Merton option pricing model based on the assumptions in the table below.

	2014	2013
Expected dividend yield	0.00%	0.00%
Weighted average expected stock price volatility	91.5%	97.3%
Range of expected stock price volatility	29% to 206%	54% to 118%
Weighted average risk-free interest rate	0.40%	0.20%
Range of risk-free interest rate	0.40%	0.20%
Expected life of options	2 years	2 years

The expected life of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. Volatility is based on the historical volatility of several public entities that are similar to the Company, as the Company does not have sufficient historical transactions of its own shares on which to base expected volatility.

Restricted Stock

As needed, the Company will grant restricted common stock to executives and consultants. These shares vest over specified time periods. With these agreements, the Company has the option to repurchase any unvested shares upon termination of the executive or consulting agreement.

An executive of the Company purchased 35,000 shares of restricted common stock during 2006 at $0.20 per share. As of the purchase date of the shares, 50% of the shares vested immediately, with the remaining to vest ratably over 32 months. As of December 31, 2014, all shares purchased were fully vested. This executive also purchased 29,000 shares of restricted common stock during 2007 at $0.20 per share. The shares vest ratably over 28 months. As of December 31, 2014, all shares purchased were fully vested. In 2008, this executive purchased 160,469 shares of restricted common stock that were granted in 2007 at $0.21 per share. As of the purchase date, approximately 96,300 shares vested immediately with the rest to vest upon completion of milestones established in Series C-1. As of December 31, 2014, none of these milestones had been achieved. In 2011, this executive purchased 343,829 shares of restricted common stock that were granted as stock options in 2010 at $0.24 per share, then modified and exercised early into restricted common stock. One-fourth of the shares will vest one year after vesting commencement and the remainder will vest at the rate of 1/48 at the end of each month thereafter. As of December 31, 2014 all shares were vested.

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Consultants of the Company purchased 75,000 shares of restricted common stock during 2007 at $0.21 per share. As of December 31, 2011, all shares purchased were fully vested. In 2008, a consultant purchased 10,000 shares of restricted common stock at $0.371 per share. As of December 31, 2014, all shares purchased were fully vested. In 2010, a consultant purchased 60,000 shares of restricted common stock at $0.29 per share. As of December 31, 2014, all shares purchased were fully vested.

Research and Development

The Company expenses research and development costs as incurred. These costs primarily consist of salaries, consulting fees, development materials and supplies directly involved in the research and development of new technology. Research and development costs totaled $751,832 and $720,796 for the years ended December 31, 2014 and 2013, respectively, and are shown as research and development expenses in the accompanying statements of operations.

Quality Assurance and Regulatory

Quality assurance and regulatory costs include direct costs associated with personnel performing quality control testing, including salary and benefit expenses. This function includes ongoing quality control testing, regulatory and compliance audits, verification and sterilization testing of products under development, and ongoing costs associated with clinical studies support. Quality assurance and regulatory costs totaled $1,302,930 and $1,064,463 for the years ended December 31, 2014 and 2013, respectively, and are shown as quality assurance and regulatory expenses in the accompanying statements of operations.

Medical Education

Medical education costs include direct costs associated with personnel performing training and coaching of physicians on the proper use of the Company s technology. These costs consist primarily of salaries and benefits, travel and physician consulting fees. Medical education costs totaled $2,357,027 and $2,056,496 for the years ended December 31, 2014 and 2013, respectively, and are shown as medical education expenses in the accompanying statements of operations.

Sales and Marketing

Sales and marketing costs include direct costs associated with personnel performing sales activities of the product and also marketing of the product and procedure through avenues like tradeshows. Sales and marketing also includes the costs that Shared Healthcare Metrics, LLC incurred in 2014. These costs totaled $415,627 for the year ended December 31, 2014. Sales and marketing costs totaled $4,352,009 and $4,140,082 for the years ended December 31, 2014 and 2013, respectively, and are shown as sales and marketing expenses in the accompanying statements of operations.

Income Taxes

The Company accounts for income taxes using an asset and liability method, which requires the recognition of deferred tax assets or liabilities for the temporary differences between financial reporting and tax bases of the Company s assets and liabilities, and for tax carryforwards at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Impairment of Long-lived Assets

The Company evaluates the recoverability of its property and equipment and other assets on an annual basis or more frequently if certain events occur that indicate impairment. The Company assesses long-lived assets for impairment by comparing net book value of such assets to the estimated future undiscounted cash flows attributable to such assets. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of these assets in relation to the operating performance of these assets and future undiscounted cash flows expected to result from the use of these assets. No such impairments have been recognized during the years ended December 31, 2014 or 2013.

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3 Inventory, Net

Inventories consist of the following at December 31:

	2014 $	2013 $
Raw materials	380,028	453,815
Work in process	7,843	65,273
Finished goods	413,408	212,908
Less reserve	(25,000)	(25,000)
Total inventory, net	776,279	706,996

4 Property and Equipment

Property and equipment, and related useful lives for depreciation purposes, consist of the following at December 31:

	2014 $	2013 $	Useful Life
Computer and phone equipment	396,139	392,076	3 to 10 years
Automobile	34,429	34,429	5 years
Software	177,994	168,717	3 years
Furniture and equipment	121,880	121,880	7 years
Production and laboratory equipment	1,129,127	923,066	3 years
Leasehold improvements	19,231	13,891	5 years
Less Accumulated depreciation	(1,547,243)	(1,373,797)	
Property and equipment, net	331,557	280,262	

Depreciation expense for the years ended December 31, 2014 and 2013, was $178,968 and $150,323, respectively.

5 Commitments and Contingencies

Leases

On May 1, 2014 the company signed a Second Lease Amendment to extend the lease on the Company s facilities until December 31, 2019. The second Amendment contains an option to extend the term for a period of five years. Rent expense is recognized on a straight-line basis and for the years ended December 31, 2014 and 2013, was $88,975 and $88,297, respectively. In addition to the lease of the Company s facilities, the Company also has operating leases for various pieces of office equipment which are included in the minimum lease payments for the years 2015, 2016 and 2017 in the table below. Future minimum lease payments under the leases through the date of termination are as follows:

Future Minimum Lease Payments	2014 $
2015	100,048
2016	102,872
2017	103,808
2018	94,310
2019	96,875
Total	497,913

6 Income Taxes

No provision or benefit for federal or state income taxes has been recorded as the Company has incurred net operating losses since inception.

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Significant components of the Company s deferred income tax assets and liabilities at December 31, 2014 and 2013, consisted of the following:

	2014 $	2013 $
Deferred income tax assets:		
Net operating loss carryforwards	17,462,046	15,668,873
Contribution carryforwards	1,887	3,295
Start-up and organization costs	316,531	359,827
Fixed assets	16,095	9,565
Inventory reserve	9,411	9,361
Deferred revenue	140,571	
Debt discount	(135)	
Deferred rent	3,025	3,564
	17,949,431	16,054,485
Less Valuation allowance	(17,949,431)	(16,054,485)
Net deferred income tax assets		

At December 31, 2014 and 2013, the Company provided a full valuation allowance against its net deferred income tax assets as management has assessed that the realization of these benefits could not be reasonably assured.

As of December 31, 2014, the Company had federal and state net operating loss carryforwards of approximately $46,618,400 and $42,963,300, respectively. These federal and state net operating loss carryforwards begin to expire in 2025. The utilization of the net operating loss and tax credit carryforwards may be subject to limitation under the rules regarding a change in stock ownership as determined by the Internal Revenue Code, and state and foreign tax laws. Section 382 of the Internal Revenue Code of 1986, as amended, imposes annual limitations on the utilization of net operating loss (NOL) carryforwards, other tax carryforwards, and certain built-in losses upon an ownership change as defined under that section. In general terms, an ownership change may result from transactions that increase the aggregate ownership of certain stockholders in the Company s stock by more than 50 percentage points over a three year testing period (Section 382 Ownership Change). If the Company has undergone a Section 382 Ownership Change, an annual limitation would be imposed on certain of the Company s tax attributes, including NOL and capital loss carryforwards, and certain other losses, credits, deductions or tax basis. As of December 31, 2014 the Company has not completed a formal study to determine whether there are 382 limitations that apply.

Taxes computed at the statutory federal income tax rate of 34% are reconciled to the provision for income taxes for the year ended December 31, 2014 and 2013, as follows:

	2014		2013	
	Amount $	Percentage of Pretax Earnings	Amount $	Percentage of Pretax Earnings

United States federal income tax at statutory rate	(1,783,991)	-(34.0)%	(977,902)	(34.0)%
State income taxes (net of federal benefit)	(176,055)	-(3.6)%	(99,010)	(3.4)%
Non-deductible expenses	63,376	1.3%	76,781	2.7%
Change in valuation reserves	1,894,946	36.3%	1,072,461	37.3%
Other	1,724	0.0%	(72,330)	(2.5)%

Provision for income taxes

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, including any state or local jurisdiction where a return may not have been filed, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2009.

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The Company previously adopted the standard regarding the accounting for uncertainty in income taxes which establishes the criterion that an individual tax position has to meet some or all of the benefits of that position to be recognized in the Company s financial statements. The difference between the tax benefit recognized in the financial statements for a position in accordance with this standard and the tax benefit claimed in the tax return is referred to as an unrecognized tax benefit. In connection with the adoption of this standard, the Company noted no such differences. During the years ended December 31, 2014 and 2013, the Company recognized no interest or penalties. The Company had no interest or penalties accrued at December 31, 2014 and 2013.

7 Notes Payable

In March 2011, the Company entered into a note payable for $34,429 with a financial institution in order to purchase a vehicle. The note payable requires monthly payments of principal and interest totaling $578 payable per month through February 2016. The interest rate for the note payable is fixed at 3.9% for a period of 5 years. Future principal payments of long-term borrowings at December 31, 2014 are as follows:

	Amount $
2015	6,754
2016	1,090
	7,844

8 Line of Credit

On July 17, 2009, the Company signed a Loan and Security Agreement with a commercial bank for a $500,000 revolving line of credit. Effective July 29, 2013, the Company signed a Seventh Amendment to the Loan and Security Agreement to increase the line to $1,000,000 and to extend the maturity date. As of December 31, 2014 and 2013, the Company has not drawn any amounts on this line of credit. The line matures on July 29, 2015 and allows for the Company to borrow up to 80% of eligible accounts receivable at an interest rate of prime plus 1.5%, with a minimum rate of 5.5%. The line is collateralized by any and all properties, rights and assets of the Company. In connection with this revolving line of credit, the Company issued 4,029 shares of Series C-1 Preferred Stock warrants with an exercise price of $3.7232 per share which were recorded for $13,166 based on the fair value of the warrants.

In connection with the Loan and Security Agreement, the Company is required to maintain all banking relationships and has provided a blanket lien on all assets including intellectual property. Additionally, the Company must meet monthly and quarterly covenants as set forth by the Bank. The Bank and the Company agreed to Amendments and Forbearance agreements whereby the bank has provided forbearance for covenants that have been defaulted and amendments to covenants. Previous agreements are as follows: First Amendment and Forbearance to the Loan and Security Agreement dated April 26, 2010, Second Amendment dated September 17, 2010, Third Amendment dated March 22, 2011, and Fourth Amendment dated July 25, 2011, and the Fifth Amendment and Default Waiver on May 22, 2012, and the Sixth Amendment and Default Waiver on February 26, 2013. In October 2014, the Company terminated the Loan and Security Agreement. At the time of the termination the Company had no outstanding draws against the line of credit.

9 Debt

On November 10, 2014, the Company signed a Loan and Security Agreement with Hercules Technology Growth Capital, Inc for a $20,000,000 term loan. The first tranche of $10,000,000 was funded on the closing date. The loan has an interest only period for the first twenty-one months followed by equal installments of principal and interest. The last payment is a balloon payment on the maturity date of November 1, 2018. The rate of interest is the greater of 9.25% or 9.25% plus prime minus 5.5%. The loan is collateralized by any and all properties, rights and assets of the Company

Upon meeting performance milestones, the Company can access two additional tranches of $5,000,000 each. The second tranche milestone is the achievement of not less than 85% of projected conservative revenues for the six months ended June 30, 2015. The second tranche is available from July 5, 2015 through August 15, 2015. The third tranche of $5,000,000 is available from April 5, 2016 through May 15, 2016 if the Company meets revenue milestones of not less than 85% of Conservative Revenue Projections for the twelve months ended March 31, 2016.

In connection with this Agreement, the Company issued 201,440 shares of Series D-1 Preferred Stock warrants with an exercise price of $3.7232 per share which were recorded for $333,445 based on the fair value of the warrants at the grant date. The holders of the warrants have the option to exercise the warrants for Series D-1 Stock, which is mandatorily redeemable for common stock if certain

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conditions are met. Accordingly, the initial fair value of the warrants was recorded as an accrued warrant liability on the consolidated balance sheets with a debt discount recorded offsetting the warrant liability. The warrants are marked to market at the end of the reporting period using the Black-Scholes valuation model. At December 31, 2014, all outstanding warrants were adjusted to the fair value of $511,709 as determined by the Company, resulting in a gain of $23,743, which has been reflected in Change in fair value of preferred stock warrants on the consolidated statement of operations. If the company borrows on the third tranche, an additional warrant of 67,147 shares of Series D-1 Preferred Stock warrants with an exercise price of $3.7232, or the most recent equity round pricing will be issued.

10 Note and Warrant Financing

In connection with the Note and Warrant Financing completed on February 10, June 4, and August 16, 2010, the Company issued 107,435 warrants, which granted investors the right to purchase shares of the capital stock into which the Notes converted. The Notes were converted into Series D Preferred Shares at $3.7232 per share on October 20, 2010 and November 5, 2010, for $4,154,081, including accrued and unpaid interest. The warrants are exercisable immediately and expire on May 1, 2017. All warrants remain outstanding as of December 31, 2014.

11 Stockholders Equity and Convertible Preferred Stock

At December 31, 2014, the Company was authorized to issue 37,599,273 shares of capital stock ($0.00001 par value), of which 20,696,284 shall be designated Common Stock and 16,902,989 shall be designated Preferred Stock (2,755,372 shares of Series A Preferred Stock, 2,619,080 shares of Series B Preferred Stock, 2,282,981 shares of Series C Preferred Stock, 1,289,210 shares of Series C-1 Preferred Stock, 4,464,726 shares of Series D Preferred Stock and 3,491,620 shares of Series D-1 Preferred Stock).

Convertible Preferred Stock

On January 31, 2013, certain members of the Company s management team purchased a total of 18,532 shares of Series D Convertible Preferred Stock for $3.7232 per share for gross proceeds of $68,998 as approved by the Board of Directors on December 5, 2012. On March 1, May 1, and June 3, 2013 a total of 2,991,066 shares of Series D-1 Preferred Stock were issued at $3.7232 per share for gross proceeds, net of Bridge Note Conversions of $7,702,576. In connection with these stock issuances, $77,470 of issuance costs were incurred in 2013. On January 31, 2014, certain members of the Company s management team purchased a total of 10,871 shares of Series D Convertible Preferred Stock for $3.7232 per share for gross proceeds of $40,475 as approved by the Board of Directors on January 27, 2014.

The following is a summary of the rights, preferences and terms of the Company s common and preferred stock from the Company s Amended Certificate of Incorporation:

Dividends

The holders of the Series A, B, C, C-1, D, Combined Preferred Stock shall be entitled to receive cumulative dividends in preference to any dividend on common stock or other preferred stock at the rate of 6% annually (as adjusted for any stock dividends, combinations or splits with respect to such shares) per annum, payable out of funds legally available therefore, when and if declared by the board of directors. Upon failure of the Company to redeem any shares of Series A, B, C, C-1, D, Combined Preferred Stock the annual dividend rate on such Series A, B, C, C-1, D, Combined Preferred Stock shall thereafter be increased to 12%.

Upon conversion of a share of Series D, Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock or Series A Preferred Stock, except for mandatory conversion, all respective accrued

or declared and unpaid dividends on such share shall be cancelled and shall not thereafter be payable.

Liquidation

In the event of (a) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary or (b) a sales, transfer or other disposition of all or substantially all the assets of the Company (a Liquidating Event), each holder of Series D Combined Preferred Stock then outstanding shall be paid, before any payment shall be made in respect of the Company s Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock, Series A Preferred Stock or Common Stock, an amount equal to the Series D Combined Original Price per share, plus accrued or declared dividends that are then unpaid for each share of Series D Combined Preferred Stock then held by them (Series D Combined Preference Amount). If, upon the occurrence of a Liquidating Event, the assets and funds thus distributed among the holders of the Series D Combined Preferred Stock shall be insufficient to permit the payment of the full Series D Combined Preference Amount, then the entire assets and funds of the Company legally available for distribution shall be distributed pro-rata among the holders of the Series D Combined Preferred Stock in proportion to the Series D Combined Preference Amount each such holder is otherwise entitled to receive.

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In the event of (a) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary or (b) a sales, transfer or other disposition of all or substantially all the assets of the Company (a Liquidating Event), each holder of Series C-1 Preferred Stock then outstanding shall be paid, after payment in full of the Series D Combined Preference Amount, before any payment shall be made in respect of the Company s Series C Preferred Stock, Series B Preferred Stock, Series A Preferred Stock or Common Stock, an amount equal to the Series C-1 Original Price per share, plus accrued or declared dividends that are then unpaid for each share of Series C-1 Preferred Stock then held by them (Series C-1 Preference Amount). If, upon the occurrence of a Liquidating Event, the assets and funds thus distributed among the holders of the Series C-1 Preferred Stock shall be insufficient to permit the payment of the full Series C-1 Preference Amount, then the remaining assets and funds of the Company legally available for distribution shall be distributed pro-rata among the holders of the Series C-1 Preferred Stock in proportion to the Series C-1 Preference Amount each such holder is otherwise entitled to receive.

In the event of (a) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary or (b) a sales, transfer or other disposition of all or substantially all the assets of the Company (a Liquidating Event), each holder of Series C Preferred Stock then outstanding shall be paid, after payment in full of the Series D Combined Preference Amount and the Series C-1 Preference Amount, before any payment shall be made in respect of the Company s Series B Preferred Stock, Series A Preferred Stock or Common Stock, an amount equal to the Series C Original Price per share, plus accrued or declared dividends that are then unpaid for each share of Series C Preferred Stock then held by them (Series C Preference Amount). If, upon the occurrence of a Liquidating Event, the assets and funds thus distributed among the holders of the Series C Preferred Stock shall be insufficient to permit the payment of the full Series C Preference Amount, then the remaining assets and funds of the Company legally available for distribution shall be distributed pro-rata among the holders of the Series C Preferred Stock in proportion to the Series C Preference Amount each such holder is otherwise entitled to receive.

In the event of (a) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary or (b) a sales, transfer or other disposition of all or substantially all the assets of the Company (a Liquidating Event), each holder of Series B Preferred Stock then outstanding shall be paid, after payment in full of the Series D Combined Preference Amount, Series C-1 Preference Amount and Series C Preference Amount, before any payment shall be made in respect of the Company s Series A Preferred Stock or Common Stock, an amount equal to the Series B Original Price per share, plus accrued or declared dividends that are then unpaid for each share of Series B Preferred Stock then held by them (Series B Preference Amount). If, upon the occurrence of a Liquidating Event, the assets and funds thus distributed among the holders of the Series B Preferred Stock shall be insufficient to permit the payment of the full Series B Preference Amount, then the remaining assets and funds of the Company legally available for distribution shall be distributed pro-rata among the holders of the Series B Preferred Stock in proportion to the Series B Preference Amount each such holder is otherwise entitled to receive.

In the event of (a) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary or (b) a sales, transfer or other disposition of all or substantially all the assets of the Company (a Liquidating Event), each holder of Series A Preferred Stock then outstanding shall be paid, after payment in full of the Series D Combined Preference Amount, Series C-1 Preference Amount, Series C Preference Amount and Series B Preference Amount, before any payment shall be made in respect of the Company s Common Stock, an amount equal to the Series A Original Price per share, plus accrued or declared dividends that are then unpaid for each share of Series A Preferred Stock then held by them (Series A Preference Amount). If, upon the occurrence of a Liquidating Event, the assets and funds thus distributed among the holders of the Series A Preferred Stock shall be insufficient to permit the payment of the full Series A Preference Amount, then the remaining assets and funds of the Company legally available for distribution shall be distributed pro-rata among the holders of the Series A Preferred Stock in proportion to the Series A Preference Amount each such holder is otherwise entitled to receive.

After payment to the holders of the Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock and Series A Preferred Stock of the full Series D Combined Preference Amount, Series C-1 Preference Amount, Series C Preference Amount, Series B Preference Amount and Series A Preference Amount, respectively, the entire remaining assets and funds of the Company legally available for distribution, if any, shall be distributed ratably among the holders of the Company s Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock, Series A Preferred Stock and Common Stock as if such shares of Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock and Series A Preferred Stock had been converted voluntarily into Common Stock immediately prior to such Liquidating Event.

Redemption

At any time following the third anniversary of the original issue date of the Series D-1 Preferred Stock, to the extent that all shares Series D Combined have not previously been redeemed or converted, the holders of at least sixty percent (60%) of the shares of Series D Combined Preferred Stock voting together as a separate class and on an as-converted to Common Stock basis, may require the Company to redeem all of the then outstanding shares of Series D Preferred Stock in three equal installments. The Company shall

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redeem such shares of Preferred Stock at a redemption price equal to the greater of (1) the Series D Combined Preference Amount as of the applicable redemption date or (2) the fair market value of the Series D Combined Preferred Stock (fair market value to be based on a valuation of the Company as determined by an independent third-party appraiser). The Company shall not redeem, purchase or acquire for value any shares of Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock or Series A Preferred Stock (or any other capital stock) unless it first redeems all Series D Combined Preferred Stock.

At any time following the later of the third anniversary of the original issue date of the Series C-1 Preferred Stock, and the date upon which all shares of Series D Combined Preferred Stock have been redeemed or converted, to the extent that all shares of Series C-1 Preferred Stock have not been previously redeemed or converted, the holders of at least sixty percent (60%) of the shares of Series C-1 Preferred Stock then outstanding may require the Company to redeem all of the then outstanding shares of Series C-1 Preferred Stock in three equal installments. The Company shall redeem such shares of Preferred Stock at a redemption price equal to the greater of (1) the Series C-1 Preference Amount as of the applicable redemption date or (2) the fair market value of the Series C-1 Preferred Stock (fair market value to be based on a valuation of the Company as determined by an independent third-party appraiser). The Company shall not redeem, purchase or acquire for value any shares of Series C Preferred Stock, Series B Preferred Stock or Series A Preferred Stock (or any other capital stock other than Series D Combined Preferred Stock) unless it first redeems all Series C-1 Preferred Stock.

At any time following the later of the fourth anniversary of the original issue date of the Series C Preferred Stock and the date upon which all shares of Series D Combined Preferred Stock and Series C-1 Preferred Stock have been redeemed or converted, to the extent that all shares of Series C Preferred Stock have not been previously redeemed or converted, the holders of at least fifty-seven percent (57%) of the shares of Series C Preferred Stock then outstanding may require the Company to redeem all of the then outstanding shares of Series C Preferred Stock in three equal installments. The Company shall redeem such shares of Preferred Stock at a redemption price equal to the greater of (1) the Series C Preference Amount as of the applicable redemption date or (2) the fair market value of the Series C Preferred Stock (fair market value to be based on a valuation of the Company as determined by an independent third-party appraiser). The Company shall not redeem, purchase or acquire for value any shares of Series B Preferred Stock or Series A Preferred Stock (or any other capital stock other than Series D Combined Preferred Stock and Series C-1 Preferred Stock) unless it first redeems all Series C Preferred Stock.

At any time following the later of the fifth anniversary of the original issue date of the Series B Preferred Stock and the date upon which all shares of Series D Combined Preferred Stock, Series C-1 Preferred Stock and Series C Preferred Stock have been redeemed or converted, to the extent that all shares of Series B Preferred Stock have not been previously redeemed or converted, the holders of a majority of the shares of Series B Preferred Stock then outstanding may require the Company to redeem all of the then outstanding shares of Series B Preferred Stock in three equal installments. The Company shall redeem such shares of Preferred Stock at a redemption price equal to the greater of (1) the Series B Preference Amount as of the applicable redemption date or (2) the fair market value of the Series B Preferred Stock (fair market value to be based on a valuation of the Company as determined by an independent third-party appraiser). The Company shall not redeem, purchase or acquire for value any shares of Series A Preferred Stock (or any other capital stock other than Series D Combined Preferred Stock, Series C-1 Preferred Stock and Series C Preferred Stock) unless it first redeems all Series B Preferred Stock.

At any time following the later of the fifth anniversary of the original issue date of the Series A Preferred Stock, and the date upon which all shares of Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock and Series B Preferred Stock have been redeemed or converted, to the extent that all shares of Series A Preferred Stock have not been previously redeemed or converted, the holders of at least two-thirds of the Series A Preferred Stock then outstanding may require the Company to redeem all of the then outstanding shares of Series A

Preferred Stock in three equal installments. The Company shall redeem such shares of Preferred Stock at a redemption price equal to the greater of (1) the Series A Preference Amount as of the applicable redemption date or (2) the fair market value of the Series A Preferred Stock (fair market value to be based on a valuation of the Company as determined by an independent third-party appraiser). The Company shall not redeem, purchase or acquire for value any other capital stock other than Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock and Series B Preferred Stock unless it first redeems all Series A Preferred Stock.

At the redemption date of each series of preferred stock, all dividends shall cease to accrue and all rights of the holders of such shares shall cease.

Conversion

Each share of Series D, D-1 Combined Preferred Stock, C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock and Series A Preferred Stock shall be convertible at the option of the holder thereof, into fully paid and nonassessable shares of Common Stock of the Company. The number of shares of Common Stock into which each share of the Series D Combined Preferred Stock may be converted shall be determined by dividing the Series D Combined Preference Amount in effect at the time of the conversion by the

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Series D Combined Conversion Price in effect at the time of the conversion. The Series D Combined Conversion Price shall be equal to $3.7232 per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares. The number of shares of Common Stock into which each share of the Series C-1 Preferred Stock may be converted shall be determined by dividing the Series C-1 Preference Amount in effect at the time of the conversion by the Series C-1 Conversion Price in effect at the time of the conversion. The Series C-1 Conversion Price shall be equal to $3.7232 per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares. The number of shares of Common Stock into which each share of the Series C Preferred Stock may be converted shall be determined by dividing the Series C Preference Amount in effect at the time of the conversion by the Series C Conversion Price in effect at the time of the conversion. The Series C Conversion Price shall be equal to $3.7232 per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares. The number of shares of Common Stock into which each share of the Series B Preferred Stock may be converted shall be determined by dividing the Series B Preference Amount in effect at the time of the conversion by the Series B Conversion Price in effect at the time of the conversion. The Series B Conversion Price shall be equal to $2.8636 per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares. The number of shares of Common Stock into which each share of the Series A Preferred Stock may be converted shall be determined by dividing the Series A Preference Amount in effect at the time of the conversion by the Series A Conversion Price in effect at the time of the conversion. The Series A Conversion Price shall be $1.9961 per share, subject to appropriate adjustment in the event of any stock dividend, stock split, combination or other similar recapitalization affecting such shares.

No fractional shares of Common Stock shall be issued upon conversion of shares of Preferred Stock. The Company shall pay a cash adjustment equal to the fair market value of such fractional share as determined in good faith by the board of directors. The Company shall pay any and all issue and other taxes that may be payable due to conversion of Preferred Stock.

The Company shall keep available, out of its authorized but unissued Common Stock, solely for the purpose of effecting the conversion of Preferred Stock, the full number of shares of Common Stock deliverable upon the conversion of all Preferred Stock from time-to-time outstanding.

In the case of any consolidation or merger, each share of Preferred Stock shall be convertible into the kind and amount of shares of stock that a holder of Common Stock of the Company deliverable upon conversion of Preferred Stock would have been entitled upon such consolidation or merger.

Mandatory Conversion

Each share of Preferred Stock shall automatically be converted into shares of Common Stock at the then applicable conversion rate upon the occurrence of a closing of an underwritten public offering pursuant to an effective registration statements under the Securities Act of 1933, as amended, covering the offer and sale of Common Stock for more than $50,000,000 (net of underwriters discounts and commissions), and the price per share to the public is not less than five times the Series D Combined Original Price, subject to adjustments for any stock dividends or stock splits. In addition, each share of Preferred Stock shall automatically be converted into shares of Common Stock at the then applicable conversion rate upon the affirmative vote of the holders of at least sixty percent (60%) of the then-outstanding shares of Series D Combined, voting together as a separate class on an as-converted to Common Stock basis.

Voting

The holder of each share of Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock and Series A Preferred Stock shall be entitled to the number of votes equal to the number of shares of Common Stock into which such share of Series D Combined Preferred Stock, Series C-1 Preferred Stock, Series C Preferred Stock, Series B Preferred Stock and Series A Preferred Stock could then be converted and shall have voting rights and powers equal to the voting rights and powers of the Common Stock. Fractional votes resulting from this shall be reduced to the nearest whole number.

The holder of each share of Series D Combined Preferred Stock is offered additional protective provisions above other holders of Preferred Stock. The protective provisions call for at least sixty percent (60%) approval of the then outstanding shares of Series D Combined Preferred Stock to take any of the following actions: (i) effect the sale, lease, license or other disposition of all or substantially all of the Company s assets; (ii) authorize any merger, consolidation or share exchange between the Company and another entity; (iii) redeem, purchase or otherwise acquire for value any shares in the Company, or declare or pay any dividends or distributions on any shares other than Series D Combined Preferred Stock; (iv) authorize any shares of capital stock superior to or on parity with the Series D Combined Preferred Stock or any securities exchangeable, convertible or exercisable for such stock; (v) alter or change any of the powers, preferences, privileges or rights of any series of Preferred Stock or change the total number of authorized shares in the Company; (vi) reclassify any shares of stock to be on parity with Series D Combined Preferred Stock; (vii) amend, repeal

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or add to any provision of the Company s Certificate of Incorporation or the Company s Bylaws; (viii) authorize the voluntary or involuntary liquidation, dissolution or winding up of the Company; (ix) authorize any public offering other than a Qualified Public Offering; (x) authorize any borrowing by the Company in excess of $100,000 or pledge any of the Company s assets as collateral, (xi) cause the Company to become subject to any agreement that would restrict the Company s performance of its obligations under the Certificate of Incorporation or Bylaws, (xii) authorize the Company to own, purchase or acquire any stock, obligations, or securities of, or any interest in, or make contribution to, any other person or entity not used in the ordinary course of business; (xiii) pursue any change in the fundamental business of the Company as it currently exists; and (xiv) change the size of the Company s Board of Directors.

Carrying Value

The Preferred Stock was originally recorded at the net proceeds received by the Company at issuance. The difference between the net proceeds and the total redemption price is being accreted using the straight-line method (which approximates the amount that would be calculated under the effective interest method) over the period from issuance until the redemption date. As of December 31, 2014 cumulative accrued dividends were $17,717,314.

12 Stock-based Compensation

On May 25, 2005, the Company adopted the 2005 Stock Plan (the Plan), as amended during 2008, 2010 and 2013 to increase the number of authorized shares. The Plan provides for the granting of up to 3,197,104 stock options to employees, directors and consultants of the Company. The board of directors shall determine the exercise price, term and dates of the exercise of all options at their grant date. Absent a public market price for the Company s common stock, the board of directors, based on an independent valuation and other factors, will determine the estimated fair market value of the common stock. The Company issues new shares of common stock upon exercise of stock options. Under the Company s stock option plan, options become vested over four years and expire not more than 10 years after the date of grant.

The Company recognizes expense related to the fair value of the stock-based compensation awards, including employee stock options.

Compensation cost for stock-based employee compensation was $97,711 and $72,639 for the years ended December 31, 2014 and 2013, respectively.

The following table summarizes the Company s stock option activity:

	Number of Shares	Weighted Average Exercise Price $
Options outstanding at December 31, 2012	1,323,635	0.25
Granted	785,168	0.42
Exercised	(63,870)	0.25
Forfeited	(69,085)	0.25
Options outstanding at December 31, 2013	1,975,848	0.32

Granted	248,000	0.45
Exercised	(18,833)	0.24
Forfeited	(136,867)	0.37
Options outstanding at December 31, 2014	2,068,148	0.33
Options exercisable at December 31, 2014	1,244,322	0.30

Intrinsic value represents the total pre-tax intrinsic value, which is computed based on the difference between the option exercise price and the fair value of the Company s common stock at December 31, 2014. This amount changes based on the fair value of the Company s stock. The total intrinsic value of options exercised during 2014 and 2013 was de minimus.

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The following table summarizes information about the Company s stock options at December 31, 2014:

Exercise Price	Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Options Exercisable	Weighted Average Remaining Contractual Life (Years)
$0.380	65,000	0.87	65,000	0.87
$0.210	15,000	2.14	15,000	2.14
$0.371	216,258	3.90	216,257	3.90
$0.290	159,211	4.98	159,211	4.98
$0.240	568,029	6.23	532,878	5.99
$0.220	166,000	7.72	98,729	7.52
$0.440	718,650	8.71	157,247	8.15
$0.450	160,000	9.83		9.80
	2,068,148		1,244,322	

The weighted average exercise price of total options exercisable at December 31, 2014 and 2013, was $0.30 and $0.28, respectively. The weighted average remaining contractual life of exercisable options at December 31, 2014 and 2013, was 5.58 and 5.85 years, respectively.

The Company will record $119,015 of future compensation cost for stock-based employee compensation over a weighted average period of approximately two years.

The weighted average grant date fair value of options granted during the fiscal years ended December 31, 2014 and 2013, was $0.15 and $0.17 per share, respectively.

The following table summarizes the status of the Company s non-vested shares as of December 31, 2014, and changes during the fiscal year ended December 31, 2014:

	Number of Shares	Weighted Average Grant Date Fair Value $
Options non-vested at December 31, 2013	920,869	0.17
Granted	248,000	0.21
Exercised	(18,833)	0.13
Vested	(354,478)	0.16
Forfeited	(136,867)	0.18
Options non-vested at December 31, 2014	658,691	0.19

13 Fair Value Measurements

ASC 820, Fair Value Measurements and Disclosures, establishes a framework for measuring fair value. That framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

That hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs derived principally from/corroborated by observable market data by correlation or other means.

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Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Changes in economic conditions or valuation techniques may require the transfer of financial instruments from one fair value to another. In such instances, the transfer is reported at the beginning of the reporting period. For the fiscal years ended December 31, 2014 and 2013, there were no transfers in and out of Level 1, 2, or 3.

The following table sets presents the Company s investments, within the fair value hierarchy, as of December 31, 2013. The Company s preferred stock warrants were measured based on unobservable inputs, and thus is considered a Level 3 financial instrument. The Company analyzes financial instruments with features of both liabilities and equity under ASC 480, *Distinguishing Liabilities from Equity*.

The following table sets presents the Company s investments, within the fair value hierarchy, as of December 31, 2013.

	Level 1 $	Level 2 $	Level 3 $	Total $
Assets:				
Investments		4,494,764		4,494,764
Liabilities:				
Warrant liability			202,007	202,007

The following table sets presents the Company s investments, within the fair value hierarchy, as of December 31, 2014.

	Level 1 $	Level 2 $	Level 3 $	Total $
Liabilities:				
Warrant liability			511,709	511,709

14 Employee Benefit Plan

Effective January 5, 2006, the Company began a 401(k) profit sharing plan, which allows eligible employees to defer up to 100% of their compensation, up to the applicable limit. The Company, at its discretion, may make matching contributions. However, no matching contributions were made during 2014 or 2013.

15 Related-party Transactions

The Company has amounts payable to employees for reimbursement of expenses incurred in the normal course of business. The total amounts payable to employees, as included in accounts payable, as of December 31, 2014 and 2013, was $140 and $145, respectively. Additionally, other current assets in the accompanying balance sheets include an employee receivable of $1,650 and $4,469 at December 31, 2014 and 2013, respectively.

The Company entered into a Membership Interest Purchase Agreement on March 5, 2014 for the purchase of 100% of the membership interests of Shared Healthcare Metrics, LLC. The Board of Directors approved this purchase agreement by written consent as it deemed it to be in the best interest of the Company.

On January 31, 2014, certain members of the Company s management team purchased a total of 10,871 shares of Series D-1 Convertible Preferred Stock for $3.7232 per share for gross proceeds of $40,475 as approved by the Board of Directors on January 27, 2014.

The Company entered into a consulting agreement with Shared Healthcare Metrics, LLC on July 8, 2013, whose owner is a related party to a member of the Company s management team. The total amounts paid in 2013, to Shared Healthcare Metrics, LLC, for consulting services was $40,253. At December 31, 2013, the total amounts payable to Shared Healthcare Metrics, LLC for consulting services and reimbursement of expenses, as included in accounts payable was $9,187.

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16 Subsequent Events

On January 31, 2015, the Company entered into a separation agreement with a former member of management. Under this agreement, the Board of Directors approved for a severance package consisting of one year s salary and accelerated vesting of options granted as part of that agreement.

On March 19, 2015 the Company sold the vehicle under financing through the Note Payable. The company received $12,000, for the sale of the vehicle and paid off the remaining balance on the Note.

On April 1, 2015 the Board of Directors approved the 6th Amendment to the Certificate of Incorporation, which increased shares allowed for Common Stock. The Board of Directors recommended and Stockholders consented to an amendment and increase to the 2005 Stock Plan of 720,000 additional shares.

The Company evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through July 13, 2015, the date the financial statements were available to be issued. All subsequent events requiring recognition and disclosure have been incorporated into these financial statements.

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UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

The following unaudited pro forma condensed combined financial information is presented to give effect to the acquisition of nContact Surgical, Inc. (nContact) by AtriCure, Inc. (AtriCure), or the Acquisition, as announced on October 4, 2015 and subsequently closed on October 13, 2015.

The unaudited pro forma condensed consolidated financial information was prepared using (i) the audited consolidated financial statements of AtriCure for the year ended December 31, 2015 incorporated by reference elsewhere in this prospectus, (ii) the unaudited consolidated financial information of nContact prior to acquisition (the period January 1, 2015 through October 13, 2015), and (iii) the preliminary purchase price allocation of the nContact acquisition, a summary of which is included in Note 2 to this unaudited pro forma condensed consolidated financial information, and (iv) the assumptions and adjustments described in the notes accompanying this unaudited pro forma condensed consolidated financial information.

The nContact acquisition was accounted for using the acquisition method of accounting. Under the acquisition method of accounting, the purchase price is required to be allocated to the underlying tangible and intangible assets acquired and liabilities assumed based on their respective fair values. Any purchase price in excess of the fair value of the acquired tangible and intangible assets is required to be allocated to goodwill in our condensed consolidated balance sheet as of the end of the period in which the acquisition closed. We performed appraisals necessary to derive preliminary fair values of the tangible and intangible assets acquired and liabilities assumed, the amounts of assets and liabilities arising from contingencies, and the amount of goodwill or bargain purchase gain to be recognized as of the acquisition date, and the related preliminary allocation of the purchase price. Such values arising from appraisals are preliminary estimates and subject to adjustment as the accounting for the acquisition is completed.

This unaudited pro forma condensed consolidated financial information should be read in conjunction with the historical consolidated audited and unaudited financial statements of AtriCure and nContact and the related audited and unaudited notes thereto included elsewhere in this prospectus.

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AtriCure, Inc. and nContact Surgical, Inc.

Condensed combined statement of operations and pro forma adjustments

For the year ended December 31, 2015 (AtriCure, Inc.) and

Pre-Acquisition period January 1, 2015 through October 13, 2015 (nContact Surgical, Inc.)

(Unaudited)

(amounts in thousands, except for per share data)

	Historical AtriCure, Inc.	Historical nContact Surgical, Inc. g)	Pro Forma Adjustments		Pro Forma Combined
Revenue	$ 129,755	$ 8,127	$ (57)	a)	$ 137,825
Cost of Revenue	36,880	1,064	457	b)	38,401
Gross profit	92,875	7,063	(514)		99,424
Operating expenses:					
Research and development expenses	25,742	2,407	245	c)	28,394
Selling, general and administrative expenses	93,853	13,645	(6,107)	d)	101,391
Total operating expenses	119,595	16,052	(5,862)		129,785
Income (loss) from operations	(26,720)	(8,989)	5,348		(30,361)
Other income (expense):					
Interest expense	(292)	(960)	960	e)	(292)
Interest Income	190	15			205
Other	(354)	47			(307)
Income (loss) before income tax expense	(27,176)	(9,887)	6,308		(30,755)
Income tax expense	(36)				(36)
Net loss	$ (27,212)	$ (9,887)	$ 6,308		$ (30,791)
Basic and diluted net loss per share	$ (0.97)				$ (0.99)
Weighted average shares outstanding - basic and diluted	28,058		2,974	f)	31,032

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AtriCure, Inc. and Subsidiaries and nContact Surgical, Inc. and Subsidiary

Notes to unaudited pro forma condensed combined financial information

(amounts in thousands)

Note 1. Basis of Presentation

The historical financial information has been adjusted to give pro forma effect to events that are (i) directly attributable to the Acquisition and related transactions, (ii) factually supportable, and (iii) with respect to the unaudited pro forma condensed combined statements of continuing operations, expected to have a continuing impact on the combined results. The pro forma adjustments are based on estimates of the fair value and useful lives of the assets acquired and liabilities assumed and have been prepared to illustrate the estimated effect of the Acquisition and certain other adjustments. The final determination of the purchase price allocation will be based on the fair values of assets acquired and liabilities assumed as of the date the Acquisition closes, and could result in significant changes to the unaudited pro forma condensed combined financial information, including goodwill.

This unaudited pro forma condensed consolidated financial information should be read in conjunction with the historical consolidated audited and unaudited financial statements of AtriCure and nContact and the related audited and unaudited notes thereto included or incorporated by reference elsewhere in this prospectus.

Note 2. nContact Acquisition

On October 13, 2015, AtriCure completed its acquisition of nContact, pursuant to the Merger Agreement, dated as of October 4, 2015. Parties to the Merger Agreement, in addition to AtriCure and nContact, include Portal Merger Sub, Inc., a Delaware corporation and wholly owned Subsidiary of AtriCure (Merger Sub), Second Portal Merger Sub, LLC, a Delaware limited liability company and wholly-owned Subsidiary of AtriCure (Second Merger Sub), and WYRP Stockholder Services, LLC, a North Carolina limited liability company and representative of the nContact equity holders. Under the terms of the Merger Agreement, nContact merged with and into Merger Sub and Merger Sub survived as a wholly owned subsidiary of AtriCure (the Merger). Immediately following the Merger, Merger Sub then merged with and into Second Merger Sub, with the Second Merger Sub surviving as a wholly owned subsidiary of AtriCure.

The aggregate consideration paid at closing to nContact s former stockholders in the Merger was paid through the issuance of 3,757 shares of AtriCure common stock and cash of $7,581. Additional consideration, contingent upon the achievement of specified clinical and revenue targets, may be paid in cash and AtriCure common stock at various dates specified by the Merger Agreement, however, the Agreement limits the total number of shares of AtriCure common stock issued in connection with the acquisition to 5,660. Additional consideration includes up to $50,000 based on the achievement of certain clinical milestones prior to December 31, 2020, and 1.5 times nContact revenues in excess of specified revenue targets in calendar years 2016 through 2019. Although the cash paid at acquisition was subject to adjustment for net working capital balances outside of a specified range, no such adjustment was made as a result of the final net working capital delivered.

The total purchase price of the acquisition is as follows:

Fair value of shares issued at closing	$ 69,054

Cash	7,581
Fair value of contingent consideration	40,207
Total Purchase Price	$ 116,842

Preliminary Purchase Price Allocation

Pursuant to the Company s business combinations accounting policy, the total purchase price for nContact was allocated to the preliminary net tangible and intangible assets based upon their preliminary fair values as set forth below. The excess of the preliminary purchase price over the preliminary net tangible assets and preliminary intangible assets was recorded as goodwill.

The Company s preliminary purchase price allocation for nContact is as follows:

Fair Value of Acquired Working Capital	$ 460
Adjustment to recognize assets and liabilities at fair value	
Property & Equipment	311
Identified intangible assets	
SUBTLE access technology (estimated 5 year life)	2,179
IPR&D (indefinite life until completion)	44,021
Goodwill	69,871
Total Purchase Price	$ 116,842

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The preliminary purchase price allocation is based on preliminary estimates and assumptions, and is subject to change during the purchase price measurement period as the Company finalizes the accounting for the acquisition. Deferred tax assets and liabilities were also recognized at acquisition date for the future tax consequences attributable to differences between the above financial statement carrying amounts of existing assets and liabilities and their respective tax bases and acquired operating loss and tax credit carryforwards of nContact. The Company recorded a full valuation allowance against the net deferred tax assets at acquisition.

Note 3. Notes to Unaudited Pro Forma Condensed Combined Statement of Continuing Operations for the year ended December 31, 2015

The unaudited pro forma condensed statement of continuing operations above reflects the following specific adjustments:

a)	Revenue	
	To conform nContact revenue recognition related to loaner generators to AtriCure policy.	$ (57)
b)	Cost of Revenue	
	To conform treatment of nContact product inventory issued to sales representatives to AtriCure policy of expensing such amounts.	$ 3
	Reclassification of certain excise taxes to cost of revenue from selling, general and administrative expense to conform to AtriCure presentation.	140
	Reclassification of depreciation expense from selling, general and administrative expenses to conform to AtriCure presentation.	108
	Reclassification of personnel expenses to cost of revenue from selling, general and administrative expenses to conform to AtriCure presentation.	35
	Reclassification of personnel expenses to cost of revenue from research and development expense to conform to AtriCure presentation.	113
	Reclassification of laboratory and warehouse facilities costs to cost of revenue from selling, general and administrative expenses to conform to AtriCure presentation.	58
	Total adjustments to cost of revenue	$ 457
c)	Research and Development Expenses	
	Reclassification of depreciation expense from selling, general and administrative expenses to conform to AtriCure presentation.	$ 17
	Reclassification of personnel expenses from research and development to selling, general and administrative expenses to conform to AtriCure presentation.	(37)
	Reclassification of personnel expenses to research and development expense from cost of revenue to conform to AtriCure presentation.	(113)
	Reclassification of laboratory and facility costs to research and development expenses from selling, general and administrative expenses to conform to AtriCure presentation.	33
	To record amortization expense for newly identified nContact intangible assets for the pre-acquisition period January 1, 2015 through October 13, 2015.	345
	Total adjustments to research and development expenses	$ 245
d)	Selling, General and Administrative Expenses	
	Reclassification of certain excise taxes to cost of revenue from selling, general and administrative expense to conform to AtriCure presentation.	$ (140)

	Reclassification of depreciation expense from selling, general and administrative expenses to conform to AtriCure presentation.	(125)
	Reclassification of personnel expenses to cost of revenue from selling, general and administrative expenses to conform to AtriCure presentation.	(35)
	Reclassification of personnel expenses from research and development to selling, general and administrative expenses to conform to AtriCure presentation.	37
	Reclassification of laboratory and facility costs to cost of revenue and research and development expenses from selling, general and administrative expenses to conform to AtriCure presentation.	(91)
	To remove transaction costs incurred by AtriCure and nContact directly related to the acquisition and included in the historical statement of operations.	(5,753)
	Total adjustments to selling, general and administrative expenses	$ (6,107)
e)	Interest Expense	
	To remove interest expense incurred on long term debt paid off in connection with the acquisition of nContact.	$ 960
f)	Weighted-average shares outstanding - basic and diluted	
	AtriCure shares issued to nContact shareholders as merger consideration, pro-rated for the pre-acquisition period January 1, 2015 through October 13, 2015.	2,974

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g) nContact Surgical, Inc. Historical Results

nContact historical results represent the period prior to acquisition date October 13, 2015, and consist of the following:

	Historical nContact nine months ended 9/30/15	Historical nContact period 10/1/15 through 10/13/15	Total Historical nContact
Revenue	$ 7,732	$ 395	$ 8,127
Cost of Revenue	1,011	53	1,064
Gross profit	6,721	342	7,063
Operating expenses:			
Research and development expenses	1,637	770	2,407
Selling, general and administrative expenses	8,802	4,843	13,645
Total operating expenses	10,439	5,613	16,052
Loss from operations	(3,718)	(5,271)	(8,989)
Other income (expense):			
Interest expense	(928)	(32)	(960)
Interest income	13	2	15
Other	46	1	47
Loss before income tax expense	(4,587)	(5,300)	(9,887)
Income tax expense			
Net loss	$ (4,587)	$ (5,300)	$ (9,887)

The historical nContact information for the nine months ended September 30, 2015 was derived from the unaudited condensed consolidated financial statements of nContact included within this filing. The historical nContact information for the period of October 1, 2015 through October 13, 2015 reflects management s compilation of such results from the internally prepared nContact financial statements and has not been audited or reviewed by an independent registered public accounting firm.

Note 4. Pro Forma Net Loss per Common Share

The pro forma basic and diluted net loss per common share is based on the weighted average number of common shares of AtriCure s common stock outstanding during the period as adjusted to reflect the shares of common stock issued as consideration in the nContact acquisition. The diluted weighted average number of common shares does not include outstanding stock options as their inclusion would be anti-dilutive.