MIMEDX GROUP, INC.
Form 10-Q
November 08, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended September 30, 2016

OR

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

For the transition period from ____________________to_____________________

Commission file number 001-35887

MIMEDX GROUP, INC.
(Exact name of registrant as specified in its charter)

Florida	26-2792552
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification Number)
1775 West Oak Commons Ct NE Marietta, GA	30062
(Address of principal executive offices)	(Zip Code)

(770) 651-9100
(Registrant’s telephone number, including area code)

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

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

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

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

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

As of October 15, 2016, there were 109,514,557 shares of the registrant’s common stock outstanding.

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Forward-Looking Statements

This Form 10-Q and certain information incorporated herein by reference contain forward-looking statements and information within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, acceptance of our products by the market, and management’s plans and objectives. In addition, certain statements included in this and our future filings with the Securities and Exchange Commission (“SEC”), in press releases, and in oral and written statements made by us or with our approval, which are not statements of historical fact, are forward-looking statements. Words such as “may,” “could,” “should,” “would,” “believe,” “expect,” “expectation,” “anticipate,” “estimate,” “intend,” “seeks,” “plan,” “project,” “will,” “should,” and other words or expressions of similar meaning are intended by us to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements are found at various places throughout this report and in the documents incorporated herein by reference. These statements are based on our current expectations about future events or results and information that is currently available to us, involve assumptions, risks, and uncertainties, and speak only as of the date on which such statements are made.

Our actual results may differ materially from those expressed or implied in these forward-looking statements. Factors that may cause such a difference include, but are not limited to, those discussed in Part II, Item 1A, “Risk Factors,” below and in our most recent Annual Report on Form 10-K, as well as other reports we file with the SEC. Except as expressly required by the federal securities laws, we undertake no obligation to update any such factors, or to publicly announce the results of, or changes to any of the forward-looking statements contained herein to reflect future events, developments, changed circumstances, or for any other reason.

As used herein, the terms “MiMedx,” “the Company,” “we,” “our” and “us” refer to MiMedx Group, Inc., a Florida corporatio and its consolidated subsidiaries as a combined entity, except where it is clear that the terms mean only MiMedx Group, Inc.

Part I - FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements

MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	September 30, 2016 (unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,338	$ 28,486
Short term investments	—	3,000
Accounts receivable, net	63,427	53,755
Inventory, net	18,313	7,460
Prepaid expenses and other current assets	6,212	3,609
Total current assets	106,290	96,310
Property and equipment, net of accumulated depreciation	13,757	9,475
Goodwill	26,951	4,040
Intangible assets, net of accumulated amortization	27,249	10,763
Deferred tax asset, net	7,019	14,838
Deferred financing costs and other assets	399	487
Total assets	$ 181,665	$ 135,913
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,162	$ 6,633
Accrued compensation	10,812	15,034
Accrued expenses	6,664	4,644
Current portion of earn out liability	9,642	—
Other current liabilities	3,298	466
Total current liabilities	41,578	26,777
Earn out liability	15,978	—
Other liabilities	832	1,148
Total liabilities	58,388	27,925
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock; $.001 par value; 5,000,000 shares authorized and 0 shares issued and outstanding	—	—
Common stock; $.001 par value; 150,000,000 shares authorized; 110,212,547 issued and 109,512,781 outstanding at September 30, 2016 and 109,467,416 issued and 107,361,471 outstanding at December 31, 2015	110	109
Additional paid-in capital	159,940	163,133
Treasury stock at cost: 699,766 shares at September 30, 2016 and 2,105,945 shares at December 31, 2015	(5,136)	(17,124)
Accumulated deficit	(31,637)	(38,130)
Total stockholders' equity	123,277	107,988
Total liabilities and stockholders' equity	$ 181,665	$ 135,913

See notes to condensed consolidated financial statements

MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	$64,429	$ 49,015	$175,139	$ 135,461
Cost of sales	7,997	4,979	23,338	15,217
Gross margin	56,432	44,036	151,801	120,244
Operating expenses:				
Research and development expenses	2,919	2,187	8,582	6,072
Selling, general and administrative expenses	48,179	34,901	131,599	96,860
Amortization of intangible assets	631	234	1,889	699
Operating income	4,703	6,714	9,731	16,613
Other income (expense), net				
Interest income (expense), net	(87)	(5)	(254)	(18)
Income before income tax provision	4,616	6,709	9,477	16,595
Income tax provision	(1,295)	(158)	(2,984)	(527)
Net income	$3,321	$ 6,551	$6,493	$ 16,068
Net income per common share - basic	$0.03	$ 0.06	$0.06	$ 0.15
Net income per common share - diluted	$0.03	$ 0.06	$0.06	$ 0.14
Weighted average shares outstanding - basic	105,991,990	106,511,294	105,927,890	106,178,136
Weighted average shares outstanding - diluted	112,361,179	114,556,036	112,193,701	114,110,120

See notes to condensed consolidated financial statements

MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)
(unaudited)

	Common Stock Issued			Treasury Stock			
	Shares	Amount	Additional Paid - in Capital	Shares	Amount	Accumulated Deficit	Total
Balance December 31, 2015	109,467,416	$ 109	$ 163,133	2,105,945	$ (17,124)	$ (38,130)	$ 107,988
Share-based compensation expense	—	—	13,826	—	—	—	13,826
Exercise of stock options	243,928	—	(2,957)	(682,082)	5,505	—	2,548
Issuance of restricted stock	501,203	1	(14,676)	(1,825,329)	14,675	—	—
Restricted stock shares cancelled/forfeited	—	—	1,070	137,575	(1,070)	—	—
Shares issued for services performed		—	6	(43,344)	340	—	346
Stock repurchase	—	—	—	1,338,616	(10,378)	—	(10,378)
Shares repurchased for tax withholding	—	—	—	109,394	(892)		(892)
Shares issued in conjunction with acquisition	—	—	(462)	(441,009)	3,808		3,346
Net income	—	—	—	—	—	6,493	6,493
Balance September 30, 2016	110,212,547	$ 110	$ 159,940	699,766	$ (5,136)	$ (31,637)	$ 123,277

See notes to condensed consolidated financial statements

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MIMEDX GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$6,493	$16,068
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	2,394	1,247
Amortization of intangible assets	1,889	699
Amortization of inventory fair value step-up	1,471	—
Amortization of deferred financing costs	136	—
Share-based compensation	13,826	12,564
Increase (decrease) in cash, net of effects of acquisition, resulting from changes in:		
Accounts receivable	(7,671)	(20,106)
Inventory	(3,599)	(520)
Prepaid expenses and other current assets	(2,023)	(1,201)
Other assets	(163)	(26)
Accounts payable	(3,941)	3,747
Accrued compensation	(4,223)	1,474
Accrued expenses	2,020	1,592
Other liabilities	2,539	(1,087)
Net cash flows from operating activities	9,148	14,451
Cash flows from investing activities:		
Purchases of equipment	(5,301)	(4,176)
Purchase of Stability Inc., net of cash acquired	(7,631)	—
Fixed maturity securities redemption	3,000	2,500
Patent application costs	(515)	(594)
Net cash flows from investing activities	(10,447)	(2,270)
Cash flows from financing activities:		
Proceeds from exercise of stock options	2,548	3,465
Stock repurchase under repurchase plan	(10,378)	(21,068)
Stock repurchase for tax withholdings on vesting of restricted stock	(892)	—
Deferred financing costs	(106)	—
Payments under capital lease obligations	(21)	(87)
Net cash flows from financing activities	(8,849)	(17,690)
Net change in cash	(10,148)	(5,509)
Cash and cash equivalents, beginning of period	28,486	46,582
Cash and cash equivalents, end of period	$18,338	$41,073

See notes to condensed consolidated financial statements

MIMEDX GROUP, INC.
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") from interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Changes to GAAP are established by the Financial Accounting Standards Board ("FASB") in the form of Accounting Standards Updates ("ASU'') to the FASB's Accounting Standards Codification ("ASC"). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included. Operating results for the nine months ended September 30, 2016 and 2015, are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2015, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

You should read these condensed consolidated financial statements together with the historical consolidated financial statements of the Company for the year ended December 31, 2015, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on February 29, 2016.

The Company operates in one business segment, Regenerative Biomaterials, which includes the design, manufacture, and marketing of products and tissue processing services for the Wound Care, Surgical, Sports Medicine, Ophthalmic and Dental market categories. The MiMedx allograft product families include our: dHACM family with AmnioFix®, EpiFix® and EpiBurn® brands; Amniotic Fluid family with OrthoFlo brand; Umbilical family with EpiCord™ and AmnioCord™ brands; Placental Collagen family with CollaFix™ and AmnioFill™ brands; Bone family with Physio® brand; and Skin family with AlloBurn™ brand. AmnioFix, EpiFix, and EpiBurn are our tissue technologies processed from human amniotic membrane; OrthoFlo is an amniotic fluid derived allograft; EpiCord™ and AmnioCord™ are derived from the umbilical cord; Physio is a bone grafting material comprised of 100% bone tissue with no added carrier; AlloBurn is a skin product derived from human skin designed for the treatment of burns; and CollaFix, our next brand we plan to commercialize, is our collagen fiber technology, developed with our patented cross-linking polymers, designed to mimic the natural composition, structure and mechanical properties of musculoskeletal tissues in order to augment their repair.

2. Significant Accounting Policies

Please see Note 2 to the Company's Consolidated Financial Statements included in the Company's Form 10-K for the fiscal year ended December 31, 2015, for a description of all significant accounting policies.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivable

Accounts receivable represent amounts due from customers for which revenue has been recognized. Generally, the Company does not require collateral or any other security to support its receivables.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing receivables. The Company determines the allowance based on factors such as historical collection experience, customers' current creditworthiness, customer concentrations, age of accounts receivable balance and general economic conditions that may affect the customers' ability to pay.

Inventories

Inventory is valued at the lower of cost or market value. The Company assesses the valuation of its inventory on a periodic basis and makes adjustments to the value for estimated excess and obsolete inventory based on estimates about future demand. The excess balance determined by this analysis becomes the basis for the Company's excess inventory charge. The Company's excess inventory review process includes analysis of sales forecasts, managing product rollovers and working with operations to maximize recovery of excess inventory. The value of inventory as of September 30, 2016 includes a fair value step - up connected with the January 2016 acquisition of Stability Inc. of approximately $600,000, which is comprised of approximately $2.1 million as of the date of the acquisition less amortization of approximately $1.5 million during the nine months ended September 30, 2016. Please see Note 4 contained herein.

Revenue Recognition
The Company sells its products through a combination of a direct sales force and independent stocking distributors and representatives in the U.S. and independent distributors in international markets. The Company recognizes revenue when title to the goods transfers to customers, provided there are no material remaining performance obligations required of the Company or any matters of customer acceptance. In cases where the Company utilizes distributors or ships product directly to the end user, it recognizes revenue upon shipment provided all other revenue recognition criteria have been met. A portion of the Company's revenue is generated from inventory maintained at hospitals, clinics and doctor's offices. For these products, revenue is recognized at the time the product has been used or implanted. The Company records estimated sales returns, discounts and allowances as a reduction of net sales in the same period revenue is recognized.
Acquisitions
Results of operations of acquired companies are included in the Company's results of operations as of the respective acquisition dates. The purchase price of each acquisition is allocated to the net assets acquired based on estimates of their fair values at the date of the acquisition. Any purchase price in excess of these net assets is recorded as goodwill. The allocation of purchase price in certain cases may be subject to revision based on the final determination of fair values during the measurement period, which may be up to one year from the acquisition date.

Contingent consideration is recognized at the estimated fair value on the acquisition date. Subsequent changes to the fair value of contingent payments are recognized in earnings. Contingent payments related to acquisitions consist of an earn out based on sales less direct production costs, and are valued using discounted cash flow techniques. The fair value of these payments is based upon probability-weighted future revenue estimates and increases or decreases as revenue estimates or expectation of timing of payments changes.
Patent Costs
The Company incurs certain legal and related costs in connection with patent applications for tissue-based products and processes. The Company capitalizes such costs to be amortized over the expected life of the patent to the extent that an economic benefit is anticipated from the resulting patent or alternative future use is available to the Company and are included in Intangible Assets in the Condensed Consolidated Balance Sheets. The Company capitalized approximately $515,000 of patent costs during the first nine months of 2016. The Company capitalized approximately $594,000 of patent costs during the first nine months of 2015.
Treasury Stock
The Company accounts for the purchase of treasury stock under the cost method. Treasury stock which is reissued for the exercise of option grants and the issuance of restricted stock grants is accounted for on a first - in first - out (FIFO) basis.
Recent Accounting Pronouncements
The Company considers the applicability and impact of all Accounting Standards Updates ("ASUs") issued, both effective and
not yet effective. In May 2014, the FASB issued ASU 2014-09, "Revenue Recognition - Revenue from Contracts with Customers" (ASU 2014-09) that requires companies to recognize revenue when a customer obtains control rather than when
companies have transferred substantially all risks and rewards of a good or service. This update is effective for annual reporting
periods beginning on or after December 15, 2017 and interim periods therein and requires expanded disclosures. The Company
is currently assessing the impact the adoption of ASU 2014-09 will have on our condensed consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes". ASU 2015-17 simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheet. ASU 2015-17 is effective for public companies for annual reporting periods beginning after December 15, 2016, and interim periods within those fiscal years. The guidance may be adopted prospectively or retrospectively and early adoption is permitted. The Company adopted this standard, prospectively, at the beginning of the fourth quarter 2015 to simplify reporting with the release of the valuation allowance as disclosed in Note 12. Prior periods were not retrospectively adjusted.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from both capital and operating leases. ASU 2016-02 is effective for public companies for annual reporting periods beginning after December 15, 2018, and interim periods within those fiscal years. The guidance may be adopted prospectively or retrospectively and early adoption is permitted. The Company is currently assessing the impact the adoption of ASU 2016-02 will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718)". The standard is
intended to simplify several areas of accounting for share - based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. This ASU is effective for fiscal years beginning after December 15, 2016. The Company is currently assessing the impact the adoption of ASU 2016-09 will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments". The update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017 and for interim periods within those fiscal years. The amendments in this update may be applied retrospectively or prospectively and early adoption is permitted. The Company is currently assessing the impact of the adoption of ASU 2016-15 will have on its consolidated financial statements.
All other ASUs issued and not yet effective for the nine months ended September 30, 2016, and through the date of this report, were assessed and determined to be either not applicable or are expected to have minimal impact on the Company's financial position or results of operations.

3. Liquidity and Management's Plans
As of September 30, 2016, the Company had approximately $18,338,000 of cash and cash equivalents. The Company reported total current assets of approximately $106,290,000 and current liabilities of approximately $41,578,000 as of September 30, 2016. The Company believes that its anticipated cash from operating and financing activities, existing cash and cash equivalents, and availability under its line of credit will enable the Company to meet its operational liquidity needs and fund its planned investing activities for the next year.

4. Acquisition of Stability Inc.

On January 13, 2016, the Company completed the acquisition of Stability Inc., d/b/a Stability Biologics ("Stability"), a provider of human tissue products to surgeons, facilities, and distributors serving the surgical, spine, and orthopedic sectors of the healthcare
industry. As a result of this transaction, the Company acquired all of the outstanding shares of Stability in exchange for
$6,000,000 cash, $3,346,000 in stock, represented by 441,009 shares of our common stock, and assumed debt of $1,771,000. Additional one time costs incurred in connection with the transaction totaled $1,088,000 and are included within selling, general and administrative expenses on the condensed consolidated statements of operations.
Contingent consideration may be payable in a formula determined by sales less certain expenses for the years 2016 and 2017. As of September 30, 2016, the contingent consideration was valued at $25,620,000 and is shown in the schedule below as fair value of earn-out. The Company used a third party specialist to assist us with the valuation. The contingent consideration was classified as a liability.

The Company has evaluated the contingent consideration for accounting purposes under GAAP and has determined that the
contingent consideration is within the scope of ASC 480 "Distinguishing Liabilities from Equity" whereby a financial instrument,
other than an outstanding share, that embodies a conditional obligation that the issuer may settle by issuing a variable number
of its equity shares shall be classified as a liability if, at inception, the monetary value of the obligation is based solely or
predominantly on variations in something other than the fair value of the issuer's equity shares.

The actual purchase price was based on cash paid, the fair value of our stock on the date of the acquisition, and direct costs associated with the combination. The actual purchase price has been preliminarily allocated as of September 30, 2016 (in thousands) and is subject to change:

Cash paid at closing	$6,000
Working capital adjustment	(480)
Common stock issued (441,009 shares valued at $9.07 per share)	3,346
Assumed debt	1,771
Fair value of earn-out	25,620
Total fair value of purchase price	$36,257

Net assets acquired:	
Debt-free working capital	$2,179
Other assets, net	199
Property, plant and equipment	1,375
Deferred tax liability	(8,268)
Subtotal	(4,515)
Intangible assets:	
Customer relationships	6,090
Patents and know-how	9,170
Trade names and trademarks	830
Non compete agreements	1,080
Licenses and permits	690
Subtotal	17,860
Goodwill	22,912
Total Assets Purchased	$36,257

Working capital and other assets were composed of the following (in thousands):

Working capital	
Cash	$140
Prepaid Expenses and other current assets	100
Accounts receivable	2,001
Federal and state taxes receivable	28
Inventory	8,725
Accounts payable and accrued expenses	(8,815)
Debt-free working capital	$2,179
Current portion of long term debt	$(194)
Long-term debt	(560)
Line of Credit	(932)
Shareholder loan	(85)
Net working capital	$408
Other assets:	
Other long term assets	$199

The acquisition was accounted for as a purchase business combination as defined by FASB Topic 805 - "Business Combinations". The fair value of the contingent consideration is measured as a Level 3 instrument. The contingent consideration liability is recorded at fair value on the acquisition date and will be remeasured quarterly until purchase accounting is completed based on the assessed fair value and adjusted if necessary. The increases or decreases in the fair value of contingent consideration can result from changes in anticipated revenue levels and changes in assumed discount periods and rates. As the fair value measured is based on significant inputs that are not observable in the market, they are categorized as

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Level 3. The income valuation approach was applied in determining the fair value of the contingent consideration using a discounted cash flow valuation technique with significant unobservable inputs comprised of projected sales and certain expenses. The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

	Estimated useful life (in years)
Intangible asset:	
Customer relationships	12
Patents and know-how	20
Trade name and Trademarks	Indefinite
Non compete agreements	4
Licenses and permits	2

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value.
Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in
the transaction and is preliminary as of September 30, 2016 and is subject to change. Goodwill is tested for impairment on an annual basis as defined by FASB Topic 350 - "Intangibles - Goodwill and Other".

The following unaudited pro forma summary financial information presents the consolidated results of operations for the Company as if the acquisition had occurred on January 1, 2015. The pro forma results are shown for illustrative purposes only and do not purport to be indicative of the results that would have been reported if the acquisition had occurred on the date indicated or indicative of the results that may occur in the future.

Unaudited pro forma information for the three and nine months ended September 30, 2016 and 2015 (in thousands) is as follows:

	Three months ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue	$64,429	$52,108	$175,687	$148,521
Net income	$3,406	$4,253	$7,074	$12,227
Income per share, fully diluted	$0.03	$0.04	$0.06	$0.11

The 2016 supplemental pro forma earnings were adjusted to exclude $1,088,000 of acquisition-related legal, audit and other
costs, net of tax. The 2015 supplemental pro forma earnings were adjusted to include $1,186,000 of amortization costs related to recorded intangible assets with defined useful lives, and $1,471,000 of inventory step-up charges as a result of the acquisition for comparability to 2016. The number of shares outstanding used in calculating the income per share for 2015 was adjusted to include 441,009 shares issued as part of the purchase price and assumed to be issued on January 1, 2015.

5. Short Term Investments

Short term investments consisted of approximately $3,000,000 of FDIC insured certificates of deposit held with various financial institutions as of December 31, 2015. The cost of these instruments approximated their fair market value at December 31, 2015.

6. Inventories

Inventories consisted of the following items as of September 30, 2016, and December 31, 2015 (in thousands):

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	September 30, 2016	December 31, 2015
Raw materials	$ 1,193	$ 602
Work in process	6,710	3,850
Finished goods	11,118	3,405
Inventory, gross	19,021	7,857
Reserve for obsolescence	(708)	(397)
Inventory, net	$ 18,313	$ 7,460

7. Property and Equipment

Property and equipment consisted of the following as of September 30, 2016, and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Leasehold improvements	$ 3,259	$ 2,684
Lab and clean room equipment	7,971	4,564
Furniture and office equipment	6,271	4,577
Construction in progress	3,629	2,629
Property and equipment, gross	21,130	14,454
Less accumulated depreciation	(7,373)	(4,979)
Property and equipment, net	$ 13,757	$ 9,475

Included in net property and equipment is approximately $427,000 of equipment covered under capital leases. The corresponding liability of approximately $41,000 is included in other liabilities in the accompanying Condensed Consolidated Balance Sheets. Interest rates for these leases range from approximately 3% to 12% with maturity dates to January 2018.

Also included in net property and equipment is approximately $1.0 million in leasehold improvements paid for by the landlord of the Company's main facility with a corresponding liability included in other liabilities which is amortized over the term of the lease.

Depreciation expense for the nine months ended September 30, 2016 and 2015, was approximately $2,394,000 and $1,247,000, respectively, and approximately $838,000 and $470,000 for the three months ended September 30, 2016 and 2015, respectively.

8. Intangible Assets and Royalty Agreement

Intangible assets are summarized as follows (in thousands):

	Weighted Average Amortization Lives	September 30, 2016	December 31, 2015
		Cost	Cost
Licenses (a) (b) (c) (d)	7 years	$ 1,699	$