

NEPHROS INC  
Form 10-Q  
August 08, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended: **June 30, 2018**

OR

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

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-32288

**NEPHROS, INC.**



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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ]  
YES [X] NO

As of August 8, 2018, 64,166,988 shares of the registrant's common stock, \$0.001 par value per share, were outstanding.

**NEPHROS, INC. AND SUBSIDIARY**

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements.

## NEPHROS, INC. AND SUBSIDIARY

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

|   | (Unaudited)<br>June 30,<br>2018 | (Audited)<br>December<br>31, 2017 |
|---|---------------------------------|-----------------------------------|
| <b>ASSETS</b>   |                                 |                                   |
| Current assets:   |                                 |                                   |
| Cash  | \$ 3,484                        | \$2,194                           |
| Accounts receivable, net  | 855                             | 836                               |
| Investment in lease, net-current portion  | 31                              | 20                                |
| Inventory, net  | 1,352                           | 674                               |
| Prepaid expenses and other current assets   | 49                              | 85                                |
| Total current assets  | 5,771                           | 3,809                             |
| Property and equipment, net   | 28                              | 52                                |
| Investment in lease, net-less current portion   | 30                              | 39                                |
| License and supply agreement, net   | 1,005                           | 1,072                             |
| Other asset   | 11                              | 11                                |
| Total assets  | \$ 6,845                        | \$4,983                           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                                   |
| Current liabilities:  |                                 |                                   |
| Secured revolving credit facility   | \$ 153                          | \$711                             |
| Current portion of secured note payable   | 187                             | -                                 |
| Accounts payable  | 679                             | 872                               |
| Accrued expenses  | 377                             | 218                               |
| Deferred revenue, current portion   | -                               | 70                                |
| Total current liabilities   | 1,396                           | 1,871                             |
| Secured note payable, net of current portion  | 951                             | -                                 |
| Unsecured long-term note payable, net of debt issuance costs and debt discount of \$0 and \$233, respectively | -                               | 954                               |
| Long-term portion of deferred revenue   | -                               | 208                               |

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|   |            |           |
|---|------------|-----------|
| Total liabilities   | 2,347      | 3,033     |
| Commitments and Contingencies (Note 15)   |            |           |
| Stockholders' equity:   |            |           |
| Preferred stock, \$.001 par value; 5,000,000 shares authorized at June 30, 2018 and December 31, 2017; no shares issued and outstanding at June 30, 2018 and December 31, 2017                                    | -          | -         |
| Common stock, \$.001 par value; 90,000,000 shares authorized at June 30, 2018 and December 31, 2017; 64,166,988 and 55,293,267 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 64         | 55        |
| Additional paid-in capital  | 127,299    | 122,924   |
| Accumulated other comprehensive income  | 74         | 77        |
| Accumulated deficit   | (122,939 ) | (121,106) |
| Total stockholders' equity  | 4,498      | 1,950     |
| Total liabilities and stockholders' equity  | \$ 6,845   | \$4,983   |

*The accompanying notes are an integral part of these unaudited condensed consolidated interim financial statements.*

## NEPHROS, INC. AND SUBSIDIARY

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except share and per share amounts)

(Unaudited)

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2018                           | 2017       | 2018                         | 2017       |
| Net revenues:  |                                |            |                              |            |
| Product revenues   | \$ 1,216                       | \$ 785     | \$ 2,174                     | \$ 1,475   |
| License, royalty and other revenues  | 150                            | 74         | 177                          | 118        |
| Total net revenues   | 1,366                          | 859        | 2,351                        | 1,593      |
| Cost of goods sold   | 536                            | 342        | 1,054                        | 621        |
| Gross margin   | 830                            | 517        | 1,297                        | 972        |
| Operating expenses:  |                                |            |                              |            |
| Research and development   | 352                            | 277        | 641                          | 507        |
| Depreciation and amortization  | 40                             | 60         | 81                           | 119        |
| Selling, general and administrative  | 1,091                          | 880        | 2,351                        | 1,651      |
| Total operating expenses   | 1,483                          | 1,217      | 3,073                        | 2,277      |
| Loss from operations   | (653 )                         | (700 )     | (1,776 )                     | (1,305 )   |
| Loss on extinguishment of debt   | -                              | -          | (199 )                       | -          |
| Interest expense   | (28 )                          | (64 )      | (114 )                       | (130 )     |
| Interest income  | 1                              | 1          | 2                            | 2          |
| Other expense  | (2 )                           | (23 )      | (24 )                        | (33 )      |
| Net loss   | (682 )                         | (786 )     | (2,111 )                     | (1,466 )   |
| Other comprehensive (loss) income, foreign currency<br>translation adjustments, net of tax | (6 )                           | 7          | (3 )                         | 8          |
| Total comprehensive loss   | \$(688 )                       | \$(779 )   | \$(2,114 )                   | \$(1,458 ) |
| Net loss per common share, basic and diluted   | \$(0.01 )                      | \$(0.01 )  | \$(0.04 )                    | \$(0.03 )  |
| Weighted average common shares outstanding, basic and<br>diluted                           | 62,456,668                     | 53,626,707 | 59,031,649                   | 51,625,048 |

The accompanying notes are an integral part of these unaudited condensed consolidated interim financial statements.

## NEPHROS, INC. AND SUBSIDIARY

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

(Unaudited)

|   | Common Stock |        | Additional<br>Paid-in | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Deficit | Total<br>Stockholders'<br>Equity |
|---|--------------|--------|-----------------------|---|------------------------|----------------------------------|
|   | Shares       | Amount | Capital               |   |                        |                                  |
| Balance, December 31, 2017 (audited)                              | 55,293,267   | \$ 55  | \$ 122,924            | \$ 77   | \$ (121,106 )          | \$ 1,950                         |
| Net loss  |              |        |                       |   | (2,111 )               | (2,111 )                         |
| Cumulative effect of adoption of ASC 606                          |              |        |                       |   | 278                    | 278                              |
| Net unrealized losses on foreign currency translation, net of tax |              |        |                       | (3 )  |                        | (3 )                             |
| Issuance of common stock, net of equity issuance costs of \$19    | 8,440,669    | 9      | 3,769                 |   |                        | 3,778                            |
| Cashless exercise of stock options                                | 22,245       | -      |                       |   |                        | -                                |
| Cancelled restricted stock shares                                 | (45,859 )    | -      |                       |   |                        | -                                |
| Exercise of warrants  | 456,666      | -      | 138                   |   |                        | 138                              |
| Noncash stock-based compensation                                  |              |        | 468                   |   |                        | 468                              |
| Balance, June 30, 2018  | 64,166,988   | \$ 64  | \$ 127,299            | \$ 74   | \$ (122,939 )          | \$ 4,498                         |

The accompanying notes are an integral part of these unaudited condensed consolidated interim financial statements.

## NEPHROS, INC. AND SUBSIDIARY

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|  | Six Months<br>Ended June 30, |           |
|--|------------------------------|-----------|
|  | 2018                         | 2017      |
| Operating activities:  |                              |           |
| Net loss   | \$(2,111)                    | \$(1,466) |
| Adjustments to reconcile net loss to net cash used in operating activities:                          |                              |           |
| Depreciation of property and equipment   | 14                           | 14        |
| Amortization of license and supply agreement   | 67                           | 105       |
| Non-cash stock-based compensation, including stock options and restricted stock                      | 468                          | 395       |
| Loss on extinguishment of debt   | 199                          | -         |
| Amortization of debt discount  | 34                           | 54        |
| Inventory reserve  | 50                           | -         |
| Allowance for doubtful accounts reserve  | 1                            | 2         |
| Loss on disposal of equipment  | 10                           | -         |
| (Gain) loss on foreign currency transactions   | (2 )                         | 13        |
| (Increase) decrease in operating assets:   |                              |           |
| Accounts receivable  | (20 )                        | (176 )    |
| Inventory  | (728 )                       | (124 )    |
| Prepaid expenses and other current assets  | 37                           | 45        |
| Increase (decrease) in operating liabilities:  |                              |           |
| Accounts payable   | (191 )                       | (85 )     |
| Accrued expenses   | 160                          | 100       |
| Deferred revenue   | -                            | (35 )     |
| Net cash used in operating activities  | (2,012)                      | (1,158)   |
| Financing activities:  |                              |           |
| Proceeds from issuance of common stock, net of equity issuance costs of \$19 and \$152, respectively | 3,778                        | 1,179     |
| Net payments on secured revolving credit facility  | (558 )                       | -         |
| Payments on secured note payable   | (49 )                        | -         |
| Proceeds from exercise of warrants   | 138                          | -         |
| Proceeds from issuance of secured note   | 1,187                        | -         |
| Repayment of unsecured long term note payable  | (1,187)                      | -         |
| Net cash provided by financing activities  | 3,309                        | 1,179     |
| Effect of exchange rates on cash   | (7 )                         | 5         |
| Net increase in cash   | 1,290                        | 26        |
| Cash, beginning of period  | 2,194                        | 275       |

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|  |         |       |
|--|---------|-------|
| Cash, end of period                              | \$3,484 | \$301 |
| Supplemental disclosure of cash flow information |         |       |
| Cash paid for interest                           | \$91    | \$77  |
| Cash paid for income taxes                       | \$3     | \$4   |

*The accompanying notes are an integral part of these unaudited condensed consolidated interim financial statements.*

## **NEPHROS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

#### **Note 1 – Organization and Nature of Operations**

Nephros, Inc. (“Nephros” or the “Company”) was incorporated under the laws of the State of Delaware on April 3, 1997. The Company was founded by health professionals, scientists and engineers affiliated with Columbia University to develop advanced end stage renal disease (“ESRD”) therapy technology and products. Today, the Company has two U.S. Food and Drug Administration-cleared products in the hemodiafiltration (“HDF”) market that deliver therapy to ESRD patients. These are the OLpūr mid-dilution HDF filter or “dialyzer,” designed expressly for HDF therapy, and the OLpūr H2H HDF module, an add-on module designed to allow the most common types of hemodialysis machines to be used for HDF therapy.

Beginning in 2009, Nephros introduced an additional, complementary business developing and marketing high performance liquid purification filters to meet the demand for water purification in certain medical markets. The Company’s filters, generally classified as ultrafilters, are primarily used in hospitals for the prevention of infection from water-borne pathogens, such as legionella and pseudomonas, and in dialysis centers for the removal of biological contaminants from water and bicarbonate concentrate. The Company is also exploring water purification applications in several commercial markets, including food and beverage, data center cooling, and military field applications.

The U.S. facilities, located at 380 Lackawanna Place, South Orange, New Jersey, 07079, are used to house the Company’s corporate headquarters and research facilities.

On June 4, 2003, Nephros International Limited was incorporated under the laws of Ireland as a wholly-owned subsidiary of the Company. In August 2003, the Company established a European office in Dublin, Ireland.

#### **Note 2 – Basis of Presentation and Liquidity**

#### **Interim Financial Information**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. Results as of and for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The condensed consolidated interim financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2017 included in the Company's Annual Report on Form 10-K.

### **Use of Estimates**

The preparation of consolidated 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 amount of revenues and expenses, during the reporting period. Actual results could differ materially from those estimates. Included in these estimates are assumptions about the collection of accounts receivable, value of inventories, useful life of fixed assets and intangible assets, and assumptions used in determining stock compensation such as expected volatility and risk-free interest rate.

### **Liquidity**

The Company has sustained operating losses and expects such losses to continue over the next several quarters. Net losses from operations since inception have generated an accumulated deficit of approximately \$122,939,000 as of June 30, 2018. On April 10, 2018, the Company completed a private placement transaction whereby the Company sold 6,540,669 shares of its common stock for aggregate net proceeds of approximately \$2,943,000. The Company believes that its cash will be sufficient to fund the Company's current operating plan through at least the next twelve months from the date of issuance of the accompanying condensed consolidated financial statements.

**Note 3 – Major Customers and Concentration of Credit Risk**

For the three and six months ended June 30, 2018, four customers accounted for 42% of the Company’s revenues. For the three months ended June 30, 2017, four customers accounted for 54% of the Company’s revenues. For the six months ended June 30, 2017, four customers accounted for 56% of the Company’s revenues. As of June 30, 2018, three customers accounted for 39% of the Company’s accounts receivable. As of December 31, 2017, two customers accounted for 29% of the Company’s accounts receivable.

For the three months ended June 30, 2018 and 2017, the following customers accounted for the following percentages of the Company’s revenues, respectively:

| Customer | 2018 | 2017 |
|----------|------|------|
| A        | 13 % | 16 % |
| B        | 13 % | 14 % |
| C        | 11 % | 12 % |
| D        | 5 %  | 12 % |

For the six months ended June 30, 2018 and 2017, the following customers accounted for the following percentages of the Company’s revenues, respectively:

| Customer | 2018 | 2017 |
|----------|------|------|
| A        | 14 % | 21 % |
| B        | 13 % | 13 % |
| C        | 9 %  | 11 % |
| D        | 6 %  | 11 % |

As of June 30, 2018 and December 31, 2017, the following customers accounted for the following percentages of the Company’s accounts receivable, respectively:

| Customer | June 30, 2018 | December 31, 2017 |
|----------|---------------|-------------------|
| B        | 15 %          | 18                |