

**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 September 30, 2019

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: **001-38546**

NEURONETICS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

33-1051425

(I.R.S. Employer Identification No.)

3222 Phoenixville Pike, Malvern, PA

(Address of principal executive offices)

19355

(Zip Code)

(610) 640-4202

(Registrant's telephone number, including area code)

Not applicable.

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Trading Symbol (s)</u>	<u>Name on each exchange on which registered</u>
Common Stock (\$0.01 par value)	STIM	The Nasdaq Global Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input checked="" type="checkbox"/>

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

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

There were 18,632,268 shares of the registrant's common stock outstanding as of October 31, 2019.

Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

NEURONETICS, INC.
Balance Sheets
(Unaudited; In thousands, except per share data)

	September 30, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 82,370	\$ 104,583
Accounts receivable, net	7,552	5,620
Inventory	2,924	2,432
Current portion of net investments in sales-type leases	633	-
Current portion of prepaid commission expense	442	-
Prepaid expenses and other current assets	1,985	1,838
Total current assets	95,906	114,473
Property and equipment, net	1,007	1,378
Operating lease right-of-use assets	3,879	-
Net investments in sales-type leases	1,141	-
Prepaid commission expense	2,465	-
Other assets	1,083	1,171
Total Assets	\$ 105,481	\$ 117,022
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 4,109	\$ 3,756
Accrued expenses	7,612	7,548
Deferred revenue	2,252	2,255
Current portion of operating lease liabilities	529	-
Current portion of long-term debt, net	7,500	-
Total current liabilities	22,002	13,559
Long-term debt, net	23,450	30,395
Deferred revenue	2,229	1,940
Operating lease liabilities	3,470	-
Deferred rent	-	86
Total Liabilities	51,151	45,980
Commitments and contingencies (Note 16)		
Stockholders' Equity:		
Preferred stock, \$0.01 par value: 10,000 shares authorized; no shares issued or outstanding at September 30, 2019 and December 31, 2018	-	-
Common stock, \$0.01 par value: 200,000 shares authorized; 18,602 and 17,744 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively	186	177
Additional paid-in capital	296,677	291,908
Accumulated deficit	(242,533)	(221,043)
Total Stockholders' Equity	54,330	71,042
Total Liabilities and Stockholders' Equity	\$ 105,481	\$ 117,022

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

NEURONETICS, INC.
Statements of Operations
(Unaudited; In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenues	\$ 16,000	\$ 13,737	\$ 45,300	\$ 37,141
Cost of revenues	4,192	3,034	11,170	8,736
Gross Profit	11,808	10,703	34,130	28,405
Operating expenses:				
Sales and marketing	10,362	9,672	31,477	27,616
General and administrative	4,285	3,238	13,145	8,952
Research and development	3,489	2,125	9,499	6,010
Total operating expenses	18,136	15,035	54,121	42,578
Loss from Operations	(6,328)	(4,332)	(19,991)	(14,173)
Other (income) expense:				
Interest expense	930	928	2,780	2,749
Other (income) expense, net	(391)	(299)	(1,281)	1,032
Net Loss	\$ (6,867)	\$ (4,961)	\$ (21,490)	\$ (17,954)
Net loss per share of common stock outstanding, basic and diluted	\$ (0.37)	\$ (0.29)	\$ (1.17)	\$ (2.99)
Weighted-average common shares outstanding, basic and diluted	18,508	17,382	18,296	6,014

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

NEURONETICS, INC.

Statement of Changes in Convertible Preferred Stock and Stockholders' Equity (Deficit)
(Unaudited; In thousands)

	Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount			
Balance at December 31, 2017	304,958	\$ 187,136	231	\$ 2	\$ 4,292	\$ (196,946)	\$ (192,652)
Share-based awards and options exercises	-	-	20	1	30	-	31
Share-based compensation expense	-	-	-	-	144	-	144
Net loss	-	-	-	-	-	(5,497)	(5,497)
Balance at March 31, 2018	304,958	187,136	251	3	4,466	(202,443)	(197,974)
Share-based awards and options exercises	-	-	6	-	7	-	7
Share-based compensation expense	-	-	-	-	192	-	192
Net loss	-	-	-	-	-	(7,496)	(7,496)
Balance at June 30, 2018	304,958	187,136	257	3	4,665	(209,939)	(205,271)
Conversion of convertible preferred stock into common stock	(304,958)	(187,136)	10,994	109	187,027	-	187,136
Conversion of convertible preferred stock warrants into common stock warrants	-	-	-	-	1,874	-	1,874
Issuance of common stock in initial public offering, net of issuance costs of \$3,465	-	-	6,325	64	96,471	-	96,535
Exercises of stock options	-	-	3	-	7	-	7
Share-based compensation expense	-	-	-	-	1,028	-	1,028
Net loss	-	-	-	-	-	(4,961)	(4,961)
Balance at September 30, 2018	-	\$ -	17,579	\$ 176	\$ 291,072	\$ (214,900)	\$ 76,348
Balance at December 31, 2018	-	\$ -	17,744	\$ 177	\$ 291,908	\$ (221,043)	\$ 71,042
Share-based awards and options exercises	-	-	483	5	1,402	-	1,407
Share-based compensation expense	-	-	-	-	501	-	501
Net loss	-	-	-	-	-	(7,529)	(7,529)
Balance at March 31, 2019	-	-	18,227	182	293,811	(228,572)	65,421
Share-based awards and options exercises	-	-	218	2	468	-	470
Share-based compensation expense	-	-	-	-	1,022	-	1,022
Net loss	-	-	-	-	-	(7,094)	(7,094)
Balance at June 30, 2019	-	-	18,445	184	295,301	(235,666)	59,819
Share-based awards and options exercises	-	-	157	2	441	-	443
Share-based compensation expense	-	-	-	-	935	-	935
Net loss	-	-	-	-	-	(6,867)	(6,867)
Balance at September 30, 2019	-	\$ -	18,602	\$ 186	\$ 296,677	\$ (242,533)	\$ 54,330

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

NEURONETICS, INC.
Statements of Cash Flows
(Unaudited; In thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>
Cash Flows from Operating Activities:		
Net loss	\$ (21,490)	\$ (17,954)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	765	671
Share-based compensation	2,458	1,364
Non-cash interest expense	555	642
Change in fair value of convertible preferred stock warrant liability	-	1,396
Cost of rental units purchased by customers	144	148
Changes in certain assets and liabilities:		
Accounts receivable, net	(1,933)	(1,016)
Inventory	(455)	(767)
Net investments in sales-type leases	(1,774)	-
Prepaid commission expense	(2,907)	-
Prepaid expenses and other assets	183	(298)
Accounts payable	10	(594)
Accrued expenses	80	(1,461)
Deferred revenue	285	(400)
Deferred rent	-	(46)
Net Cash Used in Operating Activities	<u>(24,079)</u>	<u>(18,315)</u>
Cash Flows from Investing Activities:		
Purchases of property and equipment and capitalized software	(454)	(650)
Net Cash Used in Investing Activities	<u>(454)</u>	<u>(650)</u>
Cash Flows from Financing Activities:		
Proceeds from issuances of common stock in initial public offering	-	99,998
Payments of public offering costs	-	(3,465)
Proceeds from exercises of stock options	2,320	45
Net Cash Provided by Financing Activities	<u>2,320</u>	<u>96,578</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(22,213)	77,613
Cash and Cash Equivalents, Beginning of Period	104,583	29,147
Cash and Cash Equivalents, End of Period	<u>\$ 82,370</u>	<u>\$ 106,760</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 2,240	\$ 2,057
Transfer of inventory to property and equipment	\$ 37	\$ 235
Supplemental disclosure of non-cash investing and financing activities:		
Purchases of property and equipment and capitalized software in accounts payable and accrued expenses	\$ 31	\$ -
Conversion of convertible preferred stock into common stock	-	\$ 187,136
Conversion of convertible preferred stock warrants into common stock warrants	\$ -	\$ 1,874

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

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

1. DESCRIPTION OF BUSINESS

Neuronetics, Inc., or the Company, is a commercial stage medical technology company focused on designing, developing and marketing products that improve the quality of life for patients who suffer from psychiatric disorders. The Company's first commercial product, the NeuroStar Advanced Therapy System, is a non-invasive and non-systemic office-based treatment that uses transcranial magnetic stimulation, or TMS, to create a pulsed, MRI-strength magnetic field that induces electrical currents designed to stimulate specific areas of the brain associated with mood. The system was cleared in 2008 by the United States Food and Drug Administration, or the FDA, to treat adult patients with major depressive disorder, or MDD, who have failed to achieve satisfactory improvement from prior antidepressant medication in the current episode. NeuroStar Advanced Therapy is also available in other parts of the world, including Japan, where it is listed under Japan's national health insurance. The Company intends to continue to pursue development of its NeuroStar Advanced Therapy System for additional indications.

Liquidity

As of September 30, 2019, the Company had cash and cash equivalents of \$82.4 million and an accumulated deficit of \$242.5 million. The Company incurred negative cash flows from operating activities of \$20.6 million for the year ended December 31, 2018 and \$24.1 million for the nine months ended September 30, 2019. The Company has incurred operating losses since its inception, and management anticipates that its operating losses will continue in the near term as the Company seeks to expand its sales and marketing initiatives to support its growth into existing and new markets and invest in additional research and development activities. The Company's primary sources of capital to date have been proceeds from its IPO, private placements of its convertible preferred securities, borrowings under its credit facilities and revenues from sales of its products. As of September 30, 2019, the Company had \$30.0 million of borrowings outstanding under its credit facility, which matures in March 2022. Management believes that the Company's cash and cash equivalents as of September 30, 2019 and anticipated revenues from sales of its products are sufficient to fund the Company's operations for at least the next 24 months after September 30, 2019.

2. BASIS OF PRESENTATION

The accompanying financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP. Any reference in these notes to applicable guidance is meant to refer to GAAP as found in the Accounting Standards Codification, or ASC, and Accounting Standards Updates, or ASUs, promulgated by the Financial Accounting Standards Board, or FASB.

Interim Financial Statements

The accompanying unaudited interim financial statements have been prepared from the books and records of the Company in accordance with GAAP for interim financial information and Rule 10-01 of Regulation S-X promulgated by the United States Securities and Exchange Commission, or SEC, which permit reduced disclosures for interim periods. All adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the accompanying balance sheets and statements of operations, changes in convertible preferred stock and stockholders' deficit and cash flows have been made. Although these interim financial statements do not include all of the information and footnotes required for complete annual financial statements, management believes the disclosures are adequate to make the information presented not misleading. Unaudited interim results of operations and cash flows for the three and nine months ended September 30, 2019 are not necessarily indicative of the results that may be expected for the full year. Unaudited interim financial statements and footnotes should be read in conjunction with the audited financial statements and footnotes included in the Company's Form 10-K filed with the SEC on March 5, 2019, wherein a more complete discussion of significant accounting policies and certain other information can be found.

Use of Estimates

The preparation of financial statements in accordance with GAAP and the rules and regulations of the SEC requires the use of estimates and assumptions, based on judgments considered reasonable, which 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. The Company bases its estimates and assumptions on historical experience, known trends and events and various other factors that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Although management believes its estimates and assumptions are reasonable when made, they are based upon information available at the time they are made. Management evaluates the estimates and assumptions on an ongoing basis and, if necessary, makes adjustments. Due to the risks and uncertainties involved in the Company's business and evolving market conditions and given the subjective element of the estimates and assumptions made, actual results may differ from estimated results. The most significant estimates and judgments impact share-based compensation prior to the initial public offering (IPO).

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's complete summary of significant accounting policies can be found in "Note 3. Summary of Significant Accounting Policies" in the audited financial statements included in the Company's Form 10-K filed with the SEC on March 5, 2019.

As of January 1, 2019, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606) and ASU 2016-02, "Leases" (Topic 842). The Company's accounting policies have been modified accordingly:

Revenue Recognition

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

On January 1, 2019, the Company adopted Topic 606 using the modified retrospective method applying the open contract practical expedient and accounted for those contracts which were not completed as of January 1, 2019 under Topic 606. Results for reporting periods beginning after January 1, 2019 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under Topic 605.

Impact of Topic 606 on Financial Statement Line Items

The adoption of ASC 606 had no impact to retained earnings or revenue as of January 1, 2019.

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on prepaid commissions expense on the balance sheet as of September 30, 2019 and the statement of operations for the three and nine months ended September 30, 2019 is as follows:

	<u>As of September 30, 2019</u>		
	<u>As Reported</u>	<u>Balance Without Adoption of ASC 606</u>	<u>Effect of Change Higher/(Lower)</u>
<u>Balance Sheet</u>			
Current portion of prepaid commission expense	\$ 442	\$ -	\$ 442
Prepaid commission expense	2,465	-	2,465
	<u>Three Months Ended September 30, 2019</u>		
	<u>As Reported</u>	<u>Balance Without Adoption of ASC 606</u>	<u>Effect of Change Higher/(Lower)</u>
<u>Income Statement</u>			
Sales and marketing	\$ 10,362	\$ 11,690	\$ (1,328)
Net loss	(6,867)	(8,195)	1,328
	<u>Nine Months Ended September 30, 2019</u>		
	<u>As Reported</u>	<u>Balance Without Adoption of ASC 606</u>	<u>Effect of Change Higher/(Lower)</u>
<u>Income Statement</u>			
Sales and marketing	\$ 31,477	\$ 34,384	\$ (2,907)
Net loss	(21,490)	(24,397)	2,907

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

Topic 606 is principles-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Sales and usage-based taxes are excluded from revenues. Other than the revenue recognized under the distribution agreement disclosed below, all but an immaterial amount of the Company's revenue is recognized at a point in time.

Contract Formation

The Company accounts for a contract with a customer when there is a legally enforceable contract between the Company and the customer, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. For all sales, the Company uses either a signed agreement or a binding purchase order as evidence of an arrangement.

Performance Obligations

The unit of account for Topic 606 is the performance obligation. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer or a series of distinct goods or services that are substantially the same and have the same pattern of transfer. A contract's transaction price is allocated to each performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of the Company's contracts are comprised of the following performance obligations:

- (1) The NeuroStar TMS Therapy System (the "System") which includes a chair, an electromagnet coil, a monitoring console and accessories. The various components are inputs that function together to deliver a combined output and together form one performance obligation (a NeuroStar Advanced Therapy System). Revenues from the sale of the System are satisfied at the point-in-time when delivered to the customer's premises.
- (2) NeuroStar Treatment Session (the "Treatment Session") is a single use consumable that is delivered via an encrypted activation code and is required in order for a clinician to perform trans-cranial magnetic stimulation ("TMS") therapy. Revenues from the sale of the Treatment Sessions are satisfied at the point-in-time when delivered to the customer. The Company determined that sales of Treatment Sessions are not part of the enforceable rights and obligations of the System sales, except when sold with System sales.
- (3) Separately priced extended warranties and when-and-if-available upgrade rights are considered service-type warranties. Warranty services are considered stand-ready obligations satisfied over-time and recognized using a straight-line time-based measurement toward completion.
- (4) The System clinical and reimbursement training enable the clinician to provide patient treatment. The trainings are not required in order to operate the System but are required in order to receive a certification from the Company and accordingly are not essential to the functionality of other performance obligations. Training services are recognized at a point-in-time when training is complete, typically simultaneous to or near the time of delivery of the System.

In addition, the Company has determined that there are various perfunctory deliverables such as installation of the System, the technical support hotline and marketing materials which the Company does not separately recognize as revenue nor does the Company accrue the estimated cost of providing these goods and services because they are not material. The Company provides a two-year warranty on all new System sales which were determined to be assurance-type warranties and thus not considered a separate performance obligation. The Company accrues the cost of providing these warranties.

There is no right of return or refund for any of the Company's products or services and the Company has elected to treat shipping and handling as a fulfillment activity and expenses the costs as incurred.

Rent-to-Own

The System is typically purchased but the Company does offer certain customers the option to lease instead. The Company accounts for these leases under Topic 842, *Leases*. Under Topic 842 the leases are typically accounted for as a sales-type lease which results in the derecognition of the underlying asset, the recognition of profit or loss on the sale, and the recognition of an investment in sales-type lease. The investment is periodically increased for interest earned and reduced as lease payments are received.

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

Distribution Agreement

The Company has an exclusive distribution agreement with a foreign entity for a period of 7 ½ years with two 2 year renewal options. As consideration for the right to be the sole distributor of the Company’s products and use of the Company’s intellectual property in the foreign territory, the distributor is required to make certain fixed milestone payments upon contract execution and regulatory approval. In addition, the distributor is required to make variable milestone payments depending upon regulatory reimbursement rates. Furthermore, the distributor is required to make certain minimum purchases based upon sales history and forecasts subject to a ceiling and floor. The Company assessed the potential performance obligations in this contract and concluded that the contract contained the following performance obligations:

- Exclusive distribution and intellectual property license
- NeuroStar TMS Therapy System (the “System”)
- NeuroStar Treatment Session (the “Treatment Session”)

The distribution agreement contains pricing for the Company’s products and services. The contractual purchase prices were determined to be at the standalone selling prices based on the expected sales volumes of this customer type and thus the Company concluded that this agreement did not contain a separate performance obligation for the material right to discounted Systems and Treatments Sessions. The Company allocated the transaction price through a combination of the cost plus a margin approach and the residual method. For the System and Treatment Sessions the Company maximized the use of observable inputs by beginning with average historical contractual selling prices and adjusting on a consistent and rational basis for pricing trends, the customer type and expected sales volumes and the Company’s changing cost and margins. Since it was determined that the contractual selling prices for the Company’s products and services in the distribution agreement were at the standalone selling prices, the residual consideration which is made up of the fixed and variable milestone payments was allocated to the exclusive distribution and intellectual property license. The exclusive distribution and intellectual property rights were determined to be symbolic IP and thus recognized over time. The System and Treatment Sessions were determined to be performance obligations recognized at a point in time when delivered to the distributor.

Contract Estimates

Accounting for the Company’s contracts involves the use of significant judgments and estimates including determining the separate performance obligations, allocating the transaction price to the different performance obligations and determining the method to measure the entity’s performance toward satisfaction of performance obligations that most faithfully depicts when control is transferred to the customer. The Company allocates the contract’s transaction price to each performance obligation using the Company’s best estimate of the standalone selling price for each distinct good or service in the contract. The Company maximizes the use of observable inputs by beginning with average historical contractual selling prices and adjusting as necessary and on a consistent and rational basis for other inputs such as pricing trends, customer types, volumes and changing cost and margins.

Contract Balances

Payment terms typically require payment upon shipment of the System and additional payments as access codes are delivered, which can span several years after the System is first delivered and installed. The timing of revenue recognition compared to billings and cash collections typically results in accounts receivable. However, sometimes customer advances and deposits might be required for certain customers and are recorded as contract liabilities. Changes in the contract asset and liability balances during the three and nine months ended September 30, 2019 were not materially impacted by any other factors.

As of September 30, 2019, the Company expects to recognize approximately the following percentages of deferred revenue by year:

Year:	Revenue Recognition
Remainder of 2019	30%
2020	23%
2021	11%
2022	11%
2023	11%
Thereafter	14%
Total	100%

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

Revenue recognized for the nine months ended September 30, 2019 that was included in the contract liability balance at the beginning of the year was \$2.0 million, and primarily represented revenue earned from separately priced extended warranties and clinical training.

Customers

For the three months ended September 30, 2019, no customer accounted for more than 10% of our revenues. For the nine months ended September 30, 2019, one customer accounted for 10% of our revenues. For the three and nine months ended September 30, 2018, no customer accounted for more than 10% of our revenues.

Leases

Adoption of ASC Topic 842, "Leases"

The Company accounts for leases in accordance with ASC Topic 842, Leases, ("Topic 842"). The Company determines if an arrangement is a lease at contract inception. A lease exists when a contract conveys to the customer the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. The definition of a lease embodies two conditions: (1) there is an identified asset in the contract that is land or a depreciable asset (i.e., property, plant, and equipment), and (2) the customer has the right to control the use of the identified asset.

The Company leases warehouse and office space, and office equipment pursuant to net operating leases. Operating leases where the Company is the lessor are included in revenue on the Statements of Operations.

From time to time the Company enters into sales-type lease arrangements that include a lessee obligation to purchase the leased equipment at the end of the lease term, automatic transfer of ownership of the leased equipment at the end of the lease, a bargain purchase option, or provides for minimum lease payments with a present value 90% or more of the fair value of the leased equipment at the date of lease inception. Sales-type leases where the Company is the lessor are included in revenue on the Statements of Operations.

Operating leases where the Company is the lessee are included in operating lease right-of-use assets and operating lease liabilities on the Balance Sheets. The lease liabilities are initially and subsequently measured at the present value of the unpaid lease payments at the lease commencement date.

The Company uses the following inputs in its lease calculations under Topic 842: (1) the discount rate the Company uses to discount the unpaid lease payments to present value, (2) lease term, and (3) lease payments.

- (1) Topic 842 requires a lessor to discount its unpaid lease payments using the interest rate implicit in the lease and a lessee to discount its unpaid lease payments using the interest rate implicit in the lease or, if that rate cannot be readily determined, its incremental borrowing rate. As most leases where the Company is the lessee do not provide an implicit rate, the Company uses the incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The incremental borrowing rate for a lease is the rate of interest the Company would have to pay on a collateralized basis to borrow an amount equal to the lease payments under similar terms. The Company uses the implicit rate when readily determinable.
- (2) The lease term for all leases includes the noncancelable period of the lease plus any additional periods covered by either a lessee option to extend (or not to terminate) the lease that the lessee is reasonably certain to exercise, or an option to extend (or not to terminate) the lease controlled by the lessor.
- (3) Lease payments included in the measurement of the lease asset or liability comprise the following: fixed payments (including in-substance fixed payments), and the exercise price of a lessee option to purchase the underlying asset if the lessee is reasonably certain to exercise.

For operating leases where the Company is the lessor, the Company continues recognizing the underlying asset and depreciating it over its estimated useful life. Lease income from lessees is recognized on a straight-line basis over the terms of the relevant lease agreement in revenue. Operating leases for equipment with fixed rentals and step rentals are recognized on a straight-line basis over the term of the lease, assuming no renewals, in revenue. Revenue is not recognized when collection is not reasonably assured. When collectability is not reasonably assured, the customer is placed on non-accrual status and revenue is recognized when cash payments are received.

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The lease asset for sales-type leases is initially measured as the total net investment in the lease, which comprises the initial amount of the lease receivable plus the deferred initial direct costs.

The lease asset for sales-type leases is subsequently measured throughout the lease term at the carrying amount of the net investment in the lease which is increased by interest income and reduced by lease payments collected. The lease payments are segregated into principal and interest components similar to a loan. Equipment leasing revenues are recognized on an effective interest method over the lease term. The principal component of the lease payment is reflected as a reduction to the net investment in the lease.

For operating leases where the Company is the lessee, the right-of-use (ROU) asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for lease payments made at or before the lease commencement date, plus any initial direct costs incurred less any lease incentives received. The ROU asset is subsequently measured throughout the lease term at the carrying amount of the lease liability, plus initial direct costs, plus (minus) any prepaid (accrued) lease payments, less the unamortized balance of lease incentives received. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

Lease assets for sales-type leases where the Company is the lessor and ROU assets for operating leases where the Company is the lessee are periodically reduced by impairment losses. The Company uses the loans impairment guidance in ASC Subtopic 330-10, Receivables, and the long-lived assets impairment guidance in ASC Subtopic 360-10, Property, Plant, and Equipment – Overall, to determine whether a lease asset or a ROU asset, respectively, is impaired, and if so, the amount of the impairment loss to recognize. As of September 30, 2019, the Company has not encountered any impairment losses.

The Company monitors for events or changes in circumstances that require a reassessment of a lease. When a reassessment results in the remeasurement of a lease liability, a corresponding adjustment is made to the carrying amount of the corresponding ROU asset unless doing so would reduce the carrying amount of the ROU asset to an amount less than zero. In that case, the amount of the adjustment that would result in a negative ROU asset balance is recorded in profit or loss.

The Company has elected not to recognize ROU assets and lease liabilities for all short-term leases that have a lease term of 12 months or less. The Company recognizes the lease payments associated with the short-term leases as an expense on a straight-line basis over the lease term. Variable lease payments associated with these leases are recognized and presented in the same manner as for all other leases. The Company has elected to exclude sales and other similar taxes from lease payments in arrangements where the Company is a lessor.

The Company adopted ASU 2016-02 using a modified retrospective transition approach as of the effective date as permitted by the amendments in ASU 2018-11, which provides an alternative modified retrospective transition method. As a result, the Company was not required to adjust comparative period financial information for effects of the standard or make the new required lease disclosures for periods before the date of adoption (i.e. January 1, 2019). The Company has elected to adopt the package of transition practical expedients and, therefore, has not reassessed (1) whether existing or expired contracts contain a lease, (2) lease classification for existing or expired leases or (3) the accounting for initial direct costs that were previously capitalized. The Company did not elect the practical expedient to use hindsight for leases existing at the adoption date. Further, the Company does not expect the amendments in ASU 2018-01: Land Easement Practical Expedient to have an effect on us because the Company does not enter into land easement arrangements. There was no effect of the adoption of Topic 842 on retained earnings and other components of equity as of December 31, 2018.

4. RECENT ACCOUNTING PRONOUNCEMENTS

The Company's discussion of recently issued accounting pronouncements can be found in "Note 4. Recent Accounting Pronouncements" in the audited financial statements included in the Company's Form 10-K filed with the SEC on March 5, 2019. Additionally, refer to "Note 3. Summary of Significant Accounting Policies" appearing on this Form 10-Q for additional information.

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5. FAIR VALUE MEASUREMENT AND FINANCIAL INSTRUMENTS

The carrying values of cash equivalents, accounts receivable, prepaids and other current assets, and accounts payable on the Company's balance sheets approximated their fair values as of September 30, 2019 and December 31, 2018 due to their short-term nature. The carrying values of the Company's credit facility approximated its fair value as of September 30, 2019 and December 31, 2018 due to its variable interest rate.

Certain of the Company's financial instruments are measured at fair value using a three-level hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1: Inputs are quoted prices for identical instruments in active markets.

Level 2: Inputs are quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; or model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3: Inputs are unobservable and reflect the Company's own assumptions, based on the best information available, including the Company's own data.

The following tables set forth the carrying amounts and fair values of the Company's financial instruments as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019				
	Carrying Amount	Fair Value	Fair Value Measurement Based on		
			Quoted Prices In Active Markets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets					
Money market funds (cash equivalents)	\$ 71,365	\$ 71,365	\$ 71,365	\$ -	\$ -

	December 31, 2018				
	Carrying Amount	Fair Value	Fair Value Measurement Based on		
			Quoted Prices In Active Markets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets					
Money market funds (cash equivalents)	\$ 87,062	\$ 87,062	\$ 87,062	\$ -	\$ -

The fair value of the convertible preferred stock warrant liability was estimated using the Black-Scholes option pricing model and the following inputs and assumptions as of July 2, 2018:

	July 2, 2018	
	Series E	Series F
Estimated fair value of convertible preferred stock	\$ 26.41	\$ 26.41
Exercise price	\$ 19.55	\$ 9.73
Remaining term (in years)	4.5	2.6 - 6.5
Risk-free interest rate	2.7%	2.6% - 2.8%
Expected volatility	43%	43%
Dividend yield	0%	0%

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The following table presents the changes in the Company's Level 3 instrument, the then outstanding convertible preferred stock warrant liability, measured on a recurring basis for the nine months ended September 30, 2018 (in thousands):

Balance at December 31, 2017	\$ 478
Change in fair value	1,396
Reclassification to additional paid in capital	(1,874)
Balance at September 30, 2018	<u>\$ -</u>

6. ACCOUNTS RECEIVABLE

The following table presents the composition of accounts receivable, net as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019	December 31, 2018
Gross accounts receivable - trade	\$ 8,121	\$ 6,120
Less: Allowances for doubtful accounts	(569)	(500)
Accounts receivable, net	<u>\$ 7,552</u>	<u>\$ 5,620</u>

7. PROPERTY AND EQUIPMENT AND CAPITALIZED SOFTWARE

The following table presents the composition of property and equipment, net as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019	December 31, 2018
Laboratory equipment	\$ 150	\$ 150
Office equipment	487	487
Computer equipment and software	1,191	1,050
Manufacturing equipment	273	273
Leasehold improvements	172	172
Rental equipment	920	1,262
Property and equipment, gross	3,193	3,394
Less: Accumulated depreciation	(2,186)	(2,016)
Property and equipment, net	<u>\$ 1,007</u>	<u>\$ 1,378</u>

As of September 30, 2019 and December 31, 2018, the Company had capitalized software costs, net of \$0.9 million and \$1.0 million, respectively, which are included in "Other assets" on the balance sheet.

Depreciation and amortization expense was \$0.3 million and \$0.2 million for the three months ended September 30, 2019 and 2018, respectively, and \$0.8 million and \$0.7 million for the nine months ended September 30, 2019 and September 30, 2018, respectively.

8. LEASES

Lessee:

The Company has operating leases for its corporate headquarters and office equipment, including copiers. The Company leases approximately 32,000 square foot facility in Malvern, Pennsylvania for its corporate headquarters, which includes office and warehouse space. In the first quarter of 2019, the Company signed a lease modification for its Malvern facility that extended the lease through February 2028 and included approximately 10,000 square foot of additional premises. The Company has an option to extend the lease on its combined 42,000 square foot facility for an additional five-year term; however, the Company has determined it is not reasonably certain to exercise the option at this time due to on-going personnel expansion efforts. The Company also maintains operating leases on office equipment, including copiers, which end in March 2023. The Company does not currently have any finance leases or executed leases that have not yet commenced.

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Operating lease rent expense was \$0.1 million for the three months ended September 30, 2019 and \$0.4 million for the nine months ended September 30, 2019. As of September 30, 2019 the weighted-average remaining lease term of operating leases was 8.6 years and the weighted-average discount rate was 6.5%.

The following table presents the supplemental cash flow information as a lessee related to leases (in thousands):

	<u>Nine Months Ended September 30, 2019</u>
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 330
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	\$ 4,164

The following table sets forth by year the required future payments of operating lease liabilities (in thousands):

	<u>September 30, 2019</u>
Remainder of 2019	\$ 156
2020	584
2021	613
2022	637
2023	634
Thereafter	2,791
Total lease payments	5,415
Less imputed interest	(1,416)
Present value of operating lease liabilities	<u>\$ 3,999</u>

The following table sets forth by year the minimum expected lease payments under non-cancelable operating leases (in thousands) as of December 31, 2018:

	<u>December 31, 2018</u>
2019	\$ 547
2020	560
2021	88
Total lease payments	\$ 1,195

Lessor sales-type leases:

Certain customers have purchased NeuroStar Advanced Therapy Systems on a rent-to-own basis. The lease term is three years with a customer option to purchase the NeuroStar Advanced Therapy System at the end of the lease or automatic transfer of ownership of the NeuroStar Advanced Therapy System at the end of the lease.

The following table sets forth the profit recognized on sales-type leases (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Profit recognized at commencement, net	\$ 506	\$ -	\$ 768	\$ -
Interest Income	-	-	-	-
Total sales-type lease income	<u>\$ 506</u>	<u>\$ -</u>	<u>\$ 768</u>	<u>\$ -</u>

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The following table sets forth a maturity analysis of the undiscounted lease receivables related to sales-type leases (in thousands):

	September 30, 2019
Remainder of 2019	\$ 60
2020	633
2021	633
2022	448
Total sales-type lease receivables	<u>\$ 1,774</u>

As of September 30, 2019, the carrying amount of the lease receivables is \$1.8 million. The Company does not have any unguaranteed residual assets.

Lessor operating leases:

NeuroStar Advanced Therapy Systems sold on a rent-to-own basis prior to January 1, 2019 are accounted for as operating leases. For the three months ended September 30, 2019 and 2018, the Company recognized operating lease income of \$0.2 million and \$0.3 million, respectively. For the nine months ended September 30, 2019 and September 30, 2018, the Company recognized operating lease income of \$0.6 million and \$0.7 million, respectively.

The following table sets forth a maturity analysis of its undiscounted lease receivables related to operating leases:

	September 30, 2019
Remainder of 2019	\$ 150
2020	365
2021	150
Total lease receivables	<u>\$ 665</u>

The Company maintained Rental Equipment, net of \$0.6 million and \$0.9 million, as of September 30, 2019 and December 31, 2018, respectively, which are included in "Property and equipment, net" on the balance sheet. Rental equipment depreciation expense was \$0.1 million and \$0.1 million for the three months ended September 30, 2019 and 2018, respectively, and \$0.2 million and \$0.3 million for the nine months ended September 30, 2019 and September 30, 2018, respectively.

9. PREPAID COMMISSION EXPENSE

The Company pays a commission on both NeuroStar Advanced Therapy System sales and Treatment Session sales. Since the commission paid for NeuroStar Advanced Therapy System sales is not commensurate with the commission paid for Treatment Sessions, the Company capitalizes commission expense associated with NeuroStar Advanced Therapy System commissions paid that is incremental to specifically anticipated future Treatment Session orders. In developing this estimate, the Company considered its historical Treatment Session sales and customer retention rates, as well as technology development life cycles and other industry factors. These costs are periodically reviewed for impairment.

NeuroStar Advanced Therapy System commissions are deferred and amortized on a straight-line basis over a seven year period equal to the average customer term, which the Company deems to be the expected period of benefit for these costs. As result of modified retrospective adoption method applied to open contracts only, the beginning balance as of January 1, 2019 did not include prepaid commission expense for those contracts that were substantially complete as of December 31, 2018.

On the Company's balance sheets, the current portion of capitalized contract costs is represented by the current portion of prepaid commission expense, while the long-term portion is included in prepaid commission expense. Amortization expense was \$0.1 million for the three months ended September 30, 2019 and \$0.2 million for the nine months ended September 30, 2019.

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10. ACCRUED EXPENSES

The following table presents the composition of accrued expenses as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019	December 31, 2018
Compensation and related benefits	\$ 4,764	\$ 4,909
Consulting and professional fees	387	342
Research and development expenses	50	191
Sales and marketing expenses	287	127
Warranty	737	629
Sales and other taxes payable	538	606
Interest payable	237	251
Other	612	493
Accrued expenses	<u>\$ 7,612</u>	<u>\$ 7,548</u>

11. DEBT

The following table presents the composition of debt as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019	December 31, 2018
Outstanding principal	\$ 30,000	\$ 30,000
Accrued final payment fees	1,740	1,468
Less debt discounts	(790)	(1,073)
Total long-term debt, net	<u>30,950</u>	<u>30,395</u>
Less current portion of long-term debt	<u>(7,500)</u>	<u>-</u>
Long-term debt, net	<u>\$ 23,450</u>	<u>\$ 30,395</u>

For the three months ended September 30, 2019, the Company recognized interest expense of \$0.9 million, of which \$0.7 million was cash and \$0.2 million was non-cash interest expense related to the amortization of deferred debt issuance costs and accrual of final payment fees. For the three months ended September 30, 2018, the Company recognized interest expense of \$0.9 million, of which \$0.7 million was cash and \$0.2 million was non-cash interest expense related to the amortization of deferred debt issuance costs and accrual of final payment fees.

For the nine months ended September 30, 2019, the Company recognized interest expense of \$2.8 million, of which \$2.2 million was cash and \$0.6 million was non-cash interest expense related to the amortization of deferred debt issuance costs and accrual of final payment fees. For the nine months ended September 30, 2018, the Company recognized interest expense of \$2.7 million, of which \$2.1 million was cash and \$0.6 million was non-cash interest expense related to the amortization of deferred debt issuance costs and accrual of final payment fees.

Credit Facility

In March 2017, the Company entered into a loan and security agreement with Oxford Finance LLC, or Oxford, for a credit facility that replaced its previous \$25.0 million credit facility with Oxford and which allowed it to borrow up to \$35.0 million in three tranches of term loans: a Term A Loan in the amount of \$25.0 million, which was drawn down immediately upon closing in March 2017, a Term B Loan in the amount of \$5.0 million, which was drawn down in December 2017, and a Term C Loan in the amount of \$5.0 million, which became available to the Company upon the achievement of \$45.0 million of trailing twelve month revenues during the second quarter of 2018. Upon achieving the required revenue milestone, the Company had 60 days to notify Oxford if it elected to borrow the Term C Loan. As a result of completing its IPO on July 2, 2018 and receiving the net proceeds therefrom, the Company elected not to borrow the additional \$5.0 million, and it is no longer available to the Company. Each term loan accrues interest from the date of borrowing through the date of repayment at a floating per annum rate of interest, which resets monthly and is equal to the greater of (a) 8.15% or (b) the 30-day U.S. LIBOR on the last business day of the month plus 7.38%. The Company was also required to issue to Oxford at the date of each borrowing warrants to purchase its Series F or later series of convertible preferred stock with a seven-year term and in an amount equal to 3.95% of the first \$5.0 million of each tranche borrowed. The credit facility matures and all amounts borrowed thereunder are due on March 1, 2022. As of September 30, 2019, the Company had borrowed and had outstanding an aggregate of \$30.0 million of principal under the credit facility.

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The Term A Loan featured an interest-only period through March 2019, during which time the Company was required to make monthly interest payments, after which time the Company was required to make monthly payments of principal and interest based on a 36-month amortization schedule. However, due to the achievement of \$45.0 million of revenues during fiscal year 2018, the interest-only period was extended for an additional 12 months through March 2020, after which time the Company will be required to make monthly payments of principal and interest based on a 24-month amortization schedule. In connection with the drawdown of the Term A Loan, the Company issued to Oxford a warrant to purchase shares of its Series F convertible preferred stock. On July 2, 2018, this convertible preferred stock warrant converted into a warrant to purchase 20,303 shares of the Company's common stock at an exercise price of \$9.73 per share. The warrant will expire in March 2024.

The Term B Loan featured an interest-only period through March 2019, during which time the Company was required to make monthly interest payments, after which time the Company was required to make monthly payments of principal and interest based on a 36-month amortization schedule. However, due to the achievement of \$45.0 million of revenues during the fiscal year 2018, the interest-only period was extended for an additional 12 months through March 2020, after which time the Company will be required to make monthly payments of principal and interest based on a 24-month amortization schedule. In connection with the drawdown of the Term B Loan, the Company issued to Oxford a warrant to purchase shares of its Series F convertible preferred stock. On July 2, 2018, this convertible preferred stock warrant converted into a warrant to purchase 20,303 shares of the Company's common stock at an exercise price of \$9.73 per share. The warrant will expire in December 2024.

In addition to principal and interest payments due under the credit facility, the Company is required to make final payment fees to Oxford due upon the earlier of prepayment or maturity of each tranche, which increased as a result the extension of the interest-only period and are now equal to 8.5% and 7.5% of the principal amounts of the Term A and Term B Loans, respectively. The Company accrues the estimated final payment fees using the effective interest rate, with a charge to non-cash interest expense, over the term of borrowing for each tranche. As of December 31, 2018, the effective interest rates for the Term A and Term B Loans were 11.87% and 12.14%, respectively. If the Company prepays its term loans prior to their respective scheduled maturities, it will also be required to make prepayment fees to Oxford equal to 3% if prepaid on or before the first anniversary of funding, 2% if prepaid after the first and on or before the second anniversary of funding, or 1% if prepaid after the second anniversary of funding of the principal amounts borrowed.

The Company's obligations under the credit facility are secured by a first priority security interest in substantially all of its assets, other than its intellectual property. The Company has agreed not to pledge or otherwise encumber any of its intellectual property. The loan and security agreement related to the credit facility includes a financial maintenance covenant that requires the Company to achieve at least 75% of its trailing 12-month forecasted revenues, as measured each month in accordance with a forecast that the Company provided to Oxford upon signing the agreement and future forecasts that the Company is required to deliver to Oxford each year for the life of the credit facility, as well as customary affirmative and negative covenants. The Company was in compliance with all of the covenants under its credit facility as of September 30, 2019.

The loan and security agreement related to the credit facility contains events of default, including, without limitation, events of default upon: (i) failure to make payment pursuant to the terms of the agreement; (ii) violation of covenants; (iii) material adverse changes to the Company's business; (iv) attachment or levy on the Company's assets or judicial restraint on its business; (v) insolvency; (vi) significant judgments, orders or decrees for payments by the Company not covered by insurance; (vii) incorrectness of representations and warranties; (viii) incurrence of subordinated debt; (ix) revocation of governmental approvals necessary for the Company to conduct its business; and (x) failure by the Company to maintain a valid and perfected lien on the collateral securing the borrowing.

Based on a 24-month amortization of the outstanding principal amounts of the Term A and Term B Loans beginning on April 1, 2020 as discussed above, the following table sets forth by year the Company's required future principal payments (in thousands):

<u>Year:</u>	<u>Principal Payments</u>
2019	\$ -
2020	11,250
2021	15,000
2022	3,750
Total principal payments	<u>\$ 30,000</u>

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12. COMMON STOCK

Common Stock

The Company's amended and restated certificate of incorporation as of September 30, 2019 authorized the issuance of 200.0 million shares of common stock, \$0.01 par value per share, of which 18.6 million were issued and outstanding as of September 30, 2019.

The following table summarizes the total number of shares of the Company's common stock issued and reserved for issuance as of September 30, 2019 and December 31, 2018 (in thousands):

	September 30, 2019	December 31, 2018
Shares of common stock issued	18,602	17,744
Shares of common stock reserved for issuance for:		
Common stock warrants outstanding	105	105
Stock options outstanding	2,434	2,711
Restricted stock units outstanding	240	43
Shares available for grant under stock incentive plan	1,243	1,312
Shares available for sale under employee stock purchase plan	421	244
Total shares of common stock issued and reserved for issuance	23,045	22,159

Each share of common stock entitles the holder to one vote on all matters submitted to a vote of the Company's stockholders. Holders of common stock are entitled to receive any dividends that the Company's board of directors may declare out of funds legally available for that purpose on a non-cumulative basis. The Company has never paid, and for the foreseeable future does not expect to pay, a dividend on its common stock.

Immediately prior to the closing of the Company's IPO on July 2, 2018, all of the Company's outstanding shares of convertible preferred stock converted into an aggregate of 11.0 million shares of common stock, resulting in the elimination of the Company's outstanding liquidation preferences.

Common Stock Warrants

The following table summarizes the Company's outstanding common stock warrants as of September 30, 2019 and December 31, 2018:

Warrants Outstanding (in thousands)		Exercise Price	Expiration Date
14	\$	19.55	Dec-2022
30	\$	9.73	Feb-2021
20	\$	9.73	Aug-2023
20	\$	9.73	Mar-2024
21	\$	9.73	Dec-2024
<u>105</u>			

13. LOSS PER SHARE

The Company's basic loss per common share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. The Company's restricted stock awards (non-vested shares) are issued and outstanding at the time of grant but are excluded from the Company's computation of weighted-average shares outstanding in the determination of basic loss per share until vesting occurs.

A net loss cannot be diluted, so when the Company is in a net loss position, basic and diluted loss per common share are the same. If in the future the Company achieves profitability, the denominator of a diluted earnings per common share calculation will include both the weighted-average number of shares outstanding and the number of common stock equivalents, if the inclusion of such common stock equivalents would be dilutive. Dilutive common stock equivalents potentially include warrants, stock options and non-vested restricted stock awards and units using the treasury stock method, along with the effect, if any, from the potential conversion of outstanding securities, such as convertible preferred stock.

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The following potentially dilutive securities outstanding as of September 30, 2019 and 2018 have been excluded from the denominator of the diluted loss per share of common stock outstanding calculation (in thousands):

	September 30,	
	2019	2018
Stock options	2,434	2,873
Non-vested restricted stock awards	-	7
Non-vested restricted stock units	240	38
Convertible preferred stock warrants	-	-
Common stock warrants	105	105
Shares of convertible preferred stock "as-converted"	-	-

14. SHARE-BASED COMPENSATION

The amount of share-based compensation expense recognized by the Company by location in its statements of operations for the three and nine months ended September 30, 2019 and 2018 is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Cost of revenues	\$ 18	\$ 6	\$ 47	\$ 15
Sales and marketing	368	709	976	828
General and administrative	429	273	1,126	415
Research and development	119	40	309	106
Total	<u>\$ 934</u>	<u>\$ 1,028</u>	<u>\$ 2,458</u>	<u>\$ 1,364</u>

2018 Equity Incentive Plan

In June 2018, the Company adopted the 2018 Equity Incentive Plan, or 2018 Plan, which authorized the issuance of up to 1.4 million shares, subject to an annual 4% evergreen increase, in the form of restricted stock, stock appreciation rights and stock options to the Company's directors, employees and consultants. The amount and terms of grants are determined by the Company's board of directors. All stock options granted to date have had exercise prices equal to the fair value, as determined by the closing price as reported by the Nasdaq Global Market, of the underlying common stock on the date of grant. The contractual term of stock options is up to 10 years, and stock options are exercisable in cash or as otherwise determined by the board of directors. Generally, stock options vest 25% upon the first anniversary of the date of grant and the remainder ratably monthly thereafter for 36 months. As of September 30, 2019, there were 1.2 million shares available for future issuance under the 2018 Plan.

Stock Options

The following table summarizes the Company's stock option activity for the nine months ended September 30, 2019:

	Number of Shares under Option (in thousands)	Weighted- average Exercise Price per Option	Weighted- average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2018	2,711	\$ 3.59		
Granted	802	\$ 14.82		
Exercised	(841)	\$ 2.83		
Forfeited	(238)	\$ 8.04		
Outstanding at September 30, 2019	<u>2,434</u>	\$ 7.12	7.7	\$ 8,770
Exercisable at September 30, 2019	<u>1,131</u>	\$ 2.57	6.3	\$ 6,737
Vested and expected to vest at September 30, 2019	<u>2,434</u>	\$ 7.12	7.7	\$ 8,770

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The Company recognized share-based compensation expense related to stock options of \$0.6 million and \$1.0 million for the three months ended September 30, 2019 and 2018, respectively, and \$1.6 million and \$1.3 million for the nine months ended September 30, 2019 and September 30, 2018, respectively. As of September 30, 2019, there was \$7.0 million of total unrecognized compensation cost related to non-vested stock options which the Company expects to recognize over a weighted-average period of 3.2 years. The weighted-average grant-date fair value of stock options granted during the nine months ended September 30, 2019 was estimated at \$7.99 per option. The total intrinsic value of stock options exercised during the nine months ended September 30, 2019 was \$10.6 million.

For the nine months ended September 30, 2019, the grant-date fair value of stock options was estimated at the time of grant using the following weighted-average inputs and assumptions in the Black-Scholes option pricing model:

Estimated fair value of common stock	\$	14.82
Exercise price	\$	14.82
Expected term (in years)		6.1
Risk-free interest rate		2.3%
Expected volatility		55.3%
Dividend yield		0%

Restricted Stock Awards and Restricted Stock Units

The following table summarizes the Company's restricted stock award and restricted stock unit activity for the nine months ended September 30, 2019:

	Non-vested Restricted Stock Awards (in thousands)	Weighted- average Grant-date Fair Value	Non-vested Restricted Stock Units (in thousands)	Weighted- average Grant-date Fair Value
Non-vested at December 31, 2018	4	\$ 2.32	43	\$ 25.21
Granted	-	-	232	\$ 14.38
Vested	(4)	\$ 2.32	(17)	\$ 20.83
Forfeited	-	-	(18)	\$ 15.68
Non-vested at September 30, 2019	-	-	240	\$ 15.72

The Company recognized approximately \$0.3 million and \$0.1 in share-based compensation expense related to restricted stock awards and restricted stock units for the three months ended September 30, 2019 and 2018, respectively, and \$0.9 million and \$0.1 for the nine months ended September 30, 2019 and September 30, 2018, respectively. As of September 30, 2019, there was \$3.2 million of unrecognized compensation cost related to non-vested restricted stock awards and restricted stock units, which the Company expects to recognize over a weighted-average period of 2.5 years. The total fair value at the vesting date of restricted stock awards and restricted stock units vested during the nine months ended September 30, 2019 was \$0.3 million.

15. EMPLOYEE BENEFIT PLANS

401(k) Defined Contribution Plan

The Company maintains a 401(k) defined contribution retirement plan which covers all of its employees. Employees are eligible to participate on the first of the month following their date of hire. Under the 401(k) plan, participating employees may defer up to 100% of their pre-tax salary but not more than statutory limits. There is currently no employer matching of employee contributions and employee contributions vest immediately.

2018 Employee Stock Purchase Plan

In July 2018, the Company adopted the 2018 Employee Stock Purchase Plan, or 2018 ESPP, with an initial 0.2 million share reserve, subject to automatic annual increases on January 1st of each year for a period of up to ten years, as defined in the plan document. The purpose of the 2018 ESPP is to enhance employee interest in the success and progress of the Company by encouraging employee ownership of common stock of the Company. The 2018 ESPP provides the opportunity to purchase the Company's common stock at a 15% discount to the market price through payroll deductions or lump sum cash investments. As of September 30, 2019, the Company had not yet approved any offering under the 2018 ESPP.

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

16. COMMITMENTS AND CONTINGENCIES

Executive Employment Agreements

The Company has entered into an employment agreement and offer letters with certain key executives, providing for compensation and severance in certain circumstances, as defined in the agreements.

Legal Matters

The Company is subject from time to time to various claims and legal actions arising during the ordinary course of its business. Management believes that there are currently no claims or legal actions that would reasonably be expected to have a material adverse effect on the Company's results of operations, financial condition, or cash flows.

17. DISTRIBUTION AGREEMENT WITH TEIJIN PHARMA LIMITED

In October 2017, the Company entered into a seven-and-a-half-year distribution agreement with Teijin Pharma Limited, or Teijin, for the exclusive distribution of its NeuroStar Advanced Therapy System to customers who will treat patients with MDD in Japan. Under the distribution agreement, Teijin is generally restricted from selling competing products in Japan. The distribution agreement provides that the Company will have primary responsibility for obtaining reimbursement approval for use of NeuroStar Advanced Therapy System for the treatment of MDD in Japan, and Teijin will promote the sales of NeuroStar Advanced Therapy System for treatment of MDD in Japan. The Company has agreed to provide sales and technical support training to Teijin for its NeuroStar Advanced Therapy Systems. Teijin is required to purchase minimum dollar values of NeuroStar Advanced Therapy Systems and treatment sessions from the Company.

In 2017, under the distribution agreement with Teijin, the Company received an upfront payment of \$0.75 million and a milestone payment of \$2.0 million following the Japanese Ministry of Health, Labour and Welfare's, or JMHLW, approval of marketing the NeuroStar Advanced Therapy System for the treatment of MDD in Japan. In the second quarter of 2019, under the distribution agreement with Teijin, the Company earned a second milestone payment of \$0.7 million, following Japan's Central Social Insurance Medical Council (Chuikyo) approval of the recommendation by JMHLW's expert review panel to provide reimbursement for NeuroStar Advanced Therapy for the treatment of MDD in adults. The reimbursement went into effect on June 1, 2019 and covers patients who are treated in the largest inpatient and outpatient psychiatric facilities in Japan at the rate of JPY12,000 per treatment session. These upfront and subsequent milestone payments have been deferred and are being recognized as revenue over the seven- and one-half year term of the agreement.

In May 2019, the Company and Teijin entered into an amendment to the distribution agreement, which among other things finalized transfer prices, forecasting and minimum purchases, and made certain clarifications to the agreement.

The distribution agreement is scheduled to expire on March 31, 2025, subject to earlier termination if the Company or Teijin breach the agreement, Teijin fails to maintain distributor-level permits and approvals, Teijin fails to purchase from the Company specified dollar values of its sales forecasts, reimbursement for treatment of MDD using the NeuroStar Advanced Therapy System is not obtained from JMHLW by specified dates or such reimbursement is below specified minimums, Teijin reasonably believes that it is not commercially reasonable to continue distributing the NeuroStar Advanced Therapy System in Japan or bankruptcy related events occur. The term of the distribution agreement will be automatically extended for two years unless either party gives the other party at least two years' prior written notice of non-renewal, except that the Company cannot decline to renew the agreement if Teijin has purchased 100% of its sales forecasts over the term of the agreement.

Notes to Interim Financial Statements

(Unaudited)

18. GEOGRAPHICAL SEGMENT INFORMATION

Operating segments are defined as components of an enterprise about which separate discrete information is available for evaluation by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company currently operates in one business segment as it is managed and operated as one business. A single management team that reports to the chief operating decision maker comprehensively manages the entire business. The Company does not operate any material separate lines of business or separate business entities with respect to its products or product development.

The following geographic data includes revenue generated from the Company's third-party distributors. The Company's revenue was generated in the following geographic regions and by product line for the periods indicated (in thousands):

	Revenues by Geography Three Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
United States	\$ 15,294	96%	\$ 13,518	98%
International	706	4%	219	2%
Total revenues	\$ 16,000	100%	\$ 13,737	100%

	U.S. Revenues by Product Category Three Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
(in thousands, except percentages)				
NeuroStar Advanced Therapy System	\$ 4,616	30%	\$ 3,908	29%
Treatment sessions	10,252	67%	9,218	68%
Other	426	3%	392	3%
Total U.S. revenues	\$ 15,294	100%	\$ 13,518	100%

	International Revenues by Product Category Three Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
(in thousands, except percentages)				
NeuroStar Advanced Therapy System	\$ 465	66%	\$ -	0%
Treatment sessions	114	16%	128	58%
Other	127	18%	91	42%
Total International revenues	\$ 706	100%	\$ 219	100%

	Revenues by Geography Nine Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
United States	\$ 43,730	97%	\$ 36,388	98%
International	1,570	3%	753	2%
Total revenues	\$ 45,300	100%	\$ 37,141	100%

NEURONETICS, INC.
Notes to Interim Financial Statements
(Unaudited)

U.S. Revenues by Product Category
Nine Months Ended September 30,

	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
NeuroStar Advanced Therapy System	\$ 12,594	29%	\$ 9,849	27%
Treatment sessions	29,877	68%	25,378	70%
Other	1,259	3%	1,161	3%
Total U.S. revenues	\$ 43,730	100%	\$ 36,388	100%

International Revenues by Product Category
Nine Months Ended September 30,

	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
NeuroStar Advanced Therapy System	\$ 1,002	64%	\$ 219	29%
Treatment sessions	247	16%	208	28%
Other	321	20%	326	43%
Total International revenues	\$ 1,570	100%	\$ 753	100%

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations, as well as other sections in this Quarterly Report on Form 10-Q, should be read in conjunction with our unaudited interim financial statements and related notes thereto included elsewhere herein. In addition to historical financial information, some of the information contained in the following discussion and analysis contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts, including statements regarding our future results of operations and financial position, business strategy, current and prospective products, product approvals, research and development costs, current and prospective collaborations, timing and likelihood of success, plans and objectives of management for future operations and future results of current and anticipated products, are forward-looking statements. These statements involve known and unknown risks, uncertainties, assumptions and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “could,” “intend,” “target,” “project,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these terms or other similar expressions. The forward-looking statements in this Quarterly Report on Form 10-Q are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and are subject to a number of risks, uncertainties and assumptions described in “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 5, 2019. The events and circumstances reflected in our forward-looking statements may not be achieved or occur and actual results could differ materially from those projected in the forward-looking statements. Moreover, we operate in an evolving environment. New risk factors and uncertainties may emerge from time to time, and it is not possible for us to predict all risk factors and uncertainties. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein, whether as a result of any new information, future events, changed circumstances or otherwise.

Overview

We are a commercial stage medical technology company focused on designing, developing and marketing products that improve the quality of life for patients who suffer from psychiatric disorders. Our first commercial product, the NeuroStar Advanced Therapy System, is a non-invasive and non-systemic office-based treatment that uses transcranial magnetic stimulation, or TMS, to create a pulsed, MRI-strength magnetic field that induces electrical currents designed to stimulate specific areas of the brain associated with mood. The system is cleared by the United States Food and Drug Administration, or FDA, to treat adult patients with major depressive disorder, or MDD, that have failed to achieve satisfactory improvement from prior antidepressant medication in the current MDD episode. NeuroStar Advanced Therapy is also available in other parts of the world, including Japan, where it is listed under Japan’s national health insurance. NeuroStar Advanced Therapy is safe, clinically effective, reproducible and precise and we believe is supported by the largest clinical data set of any competing TMS system. We believe we are the market leader in TMS therapy based on our U.S. installed base of 1,032 active NeuroStar Advanced Therapy Systems in approximately 833 psychiatrist offices as of September 30, 2019 and the estimated 76,200 patients treated with approximately 2.7 million of our treatment sessions through such date. We generated revenues of \$16.0 million and \$45.3 million for the three and nine months ended September 30, 2019, respectively.

We designed the NeuroStar Advanced Therapy System as a non-invasive therapeutic alternative to treat patients who suffer from MDD and to address many of the key limitations of existing treatment options. We generate revenues from initial capital sales of our systems, recurring treatment sessions and service and repair and extended warranty contracts. We derive the majority of our revenues from recurring treatment sessions. For the three months ended September 30, 2019, revenues from sales of our treatment sessions and NeuroStar Advanced Therapy Systems represented 67% and 30% of our U.S. revenues, respectively. For the nine months ended September 30, 2019, revenues from sales of our treatment sessions and NeuroStar Advanced Therapy Systems represented 68% and 29% of our U.S. revenues, respectively.

We currently sell our NeuroStar Advanced Therapy System and recurring treatment sessions in the United States with the collaborative support of our 236 employees as of September 30, 2019. Our sales force primarily targets 15,100 psychiatrists at 3,600 high-decile psychiatric practices that we estimate, based on data from Symphony Health and our own internal estimates, treat approximately 33% of the total MDD patients in the United States who meet our labeled indication and are insured. We expect to continue to expand our direct sales and customer support team to further penetrate the market by demonstrating the benefits of our NeuroStar Advanced Therapy to psychiatrists and their MDD patients. Some of our customers have and may purchase more than one NeuroStar Advanced Therapy System. Based on our commercial data, we believe psychiatrists can recoup their initial capital investment in our system by providing a standard course of treatment to approximately 12 patients. We believe psychiatrists can generate approximately \$7,500 to \$10,000 of revenue per patient for a standard course of treatment, which may provide meaningful

incremental income to their practices. We have a diverse customer base of psychiatrists in group psychiatric practices in the United States. For the three months ended September 30, 2019, no customer accounted for more than 10% of our revenues. For nine months ended September 30, 2019, one customer accounted for 10% of our revenues. For the three and nine months ended September 30, 2018, no customer accounted for more than 10% of our revenues. Medicare and the vast majority of commercial payors in the United States Patients are reimbursed for treatment sessions utilizing our NeuroStar Advanced Therapy System.

We market our products in a few select markets outside the United States through independent distributors. International revenues represented 3% and 2% of our total revenues for the nine months ended September 30, 2019 and September 30, 2018, respectively. In October 2017, we entered into an exclusive distribution agreement with Teijin Pharma Limited, or Teijin, for the distribution of our NeuroStar Advanced Therapy Systems and treatment sessions to customers who will treat patients with MDD in Japan. We received regulatory approval for our system in Japan in September 2017, and we received the initial reimbursement of JPY 12,000 per treatment session, which went into effect on June 1, 2019. We expect our international revenues to increase over time as a percentage of our total revenues as we grow our presence in Japan.

Our research and development efforts are focused on the following: hardware and software product developments and enhancements of our NeuroStar Advanced Therapy System and clinical development relating to additional indications, which may include bipolar depression and post-traumatic stress disorder. We outsource the manufacture of components of our NeuroStar Advanced Therapy Systems that are produced to our specifications, and individual components are either shipped directly from our third-party contract manufacturers to our customers or consolidated into pallets at our Malvern, Pennsylvania facility prior to shipment. Final installation of these systems occurs at the customer site.

Our total revenues increased by \$2.3 million, or 16%, from \$13.7 million for the three months ended September 30, 2018 to \$16.0 million for the three months ended September 30, 2019 and by \$8.2 million, or 22%, from \$37.1 million for nine months ended September 30, 2018 to \$45.3 million for the nine months ended September 30, 2019. For the three and nine months ended September 30, 2019, our U.S. revenues were \$15.3 million and \$43.7 million and compared to \$13.5 million and \$36.4 million for the three and nine months ended September 30, 2018, respectively, which represent an increase of 13% and 20% period over period. Due to the seasonality of our sales, during the first quarter of each year, we typically experience reduced revenues compared to our other quarters. We incurred net losses of \$6.9 million and \$21.5 million for the three and nine months ended September 30, 2019 compared to net losses of \$5.0 million and \$18.0 million for the three and nine months ended September 30, 2018, respectively. We expect to continue to incur losses for the next several years as we expand our commercial organization to support our planned sales growth and while continuing to invest in our pipeline indications. As of September 30, 2019, we had an accumulated deficit of \$242.5 million.

Components of Our Results of Operations

Revenues

To date, we have generated revenues primarily from the capital portion of our business and related sales and rentals of the NeuroStar Advanced Therapy System and the recurring revenues from our sale of treatment sessions in the United States.

NeuroStar Advanced Therapy System Revenues. NeuroStar Advanced Therapy System revenues consist primarily of sales or rentals of a capital component, including upgrades to the equipment attributable to the initial sale of the system. NeuroStar Advanced Therapy Systems can be purchased outright or on a rent-to-own basis by certain customers. We had an installed base of 1,032 and 858 active NeuroStar Advanced Therapy Systems as of September 30, 2019 and 2018, respectively.

Treatment Session Revenues. Treatment session revenues primarily include sales of NeuroStar Treatment Sessions and SenStar treatment links. The NeuroStar Treatment Sessions are access codes that are delivered electronically in the United States. The SenStar treatment links are disposable units containing single-use access codes that are sold and used outside the United States. Access codes are purchased separately by our customers, primarily on an as-needed basis, and are required by the NeuroStar Advanced Therapy System in order to deliver treatment sessions.

Other Revenues. Other revenues are derived primarily from service and repair and extended warranty contracts with our existing customers.

We refer you to the section titled “Critical Accounting Policies and Use of Estimates—Revenue Recognition” appearing in our Form 10-K filed with the SEC on March 5, 2019. We also refer you to “Note 3. Summary of Significant Accounting Policies” and “Note 4. Recent Accounting Pronouncements” appearing on this Form 10-Q for additional information regarding how we account for revenues.

Cost of Revenues and Gross Margin

Cost of revenues primarily consists of the costs of components and products purchased from our third-party contract manufacturers of our NeuroStar Advanced Therapy Systems as well as the cost of treatment packs for individual treatment sessions. We use third-party contract manufacturing partners to produce the components for and assemble the completed NeuroStar Advanced Therapy Systems. Cost of revenues also includes costs related to personnel, royalties, warranty, shipping, and our operations and field service departments. We expect our cost of revenues to increase in absolute dollars as and to the extent our revenues grow.

Our gross profit is calculated by subtracting our cost of revenues from our revenues. We calculate our gross margin as our gross profit divided by our revenues. Our gross margin has been and will continue to be affected by a variety of factors, primarily product sales mix, pricing and third-party contract manufacturing costs. Our gross margins on revenues from sales of NeuroStar Advanced Therapy Systems are lower than our gross margins on revenues from sales of treatment sessions and, as a result, the sales mix between NeuroStar Advanced Therapy Systems and treatment sessions can affect the gross margin in any reporting period.

Sales and Marketing Expenses

Sales and marketing expenses consist of market research and commercial activities related to the sale of our NeuroStar Advanced Therapy Systems and treatment sessions and salaries and related benefits, sales commissions and share-based compensation for employees focused on these efforts. Other significant sales and marketing costs included conferences and trade shows, promotional and marketing activities, including direct and online marketing, practice support programs, television and radio media campaigns, travel and training expenses.

We anticipate a significant increase in headcount in our commercial organization and in expenses in executing on our growth initiatives as we continue to expand our business in the United States and internationally. As a result, we expect our sales and marketing expenses to continue to increase in absolute dollars.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel expenses, including salaries and related benefits, share-based compensation and travel expenses, for employees in executive, finance, information technology, legal and human resource functions. General and administrative expenses also include the cost of insurance, outside legal fees, accounting and other consulting services, audit fees from our independent registered public accounting firm, board of directors' fees and other administrative costs, such as corporate facility costs, including rent, utilities, depreciation and maintenance not otherwise included in cost of revenues.

We anticipate that our general and administrative expenses will increase in absolute dollars because of an expanded infrastructure and an increased headcount. We anticipate higher corporate infrastructure costs including, but not limited to, accounting, legal, human resources, consulting and investor relations fees, listing fees on the Nasdaq Global Market, costs associated with SEC reporting and compliance, as well as increased director and officer insurance premiums, as a result of our current status as a public company.

Research and Development Expenses

Research and development expenses consist primarily of personnel expenses, including salaries and related benefits and share-based compensation for employees in clinical development, product development, regulatory and quality assurance functions, as well as expenses associated with outsourced professional scientific development services and costs of investigative sites and consultants that conduct our preclinical and clinical development programs. We typically use our employee, consultant and infrastructure resources across our research and development programs.

We plan to incur research and development expenses for the near future as we expect to continue our development of TMS Therapy for the treatment of additional patient populations and new indications, which may include bipolar depression, post-traumatic stress disorder and potential other clinical indications yet to be determined, as well as for various hardware and software development projects. As a result, we expect our research and development expenses to continue to increase in absolute dollars.

Interest Expense

Interest expense consists of cash interest payable under our credit facility and non-cash interest attributable to the accrual of final payment fees and the amortization of deferred financing costs related to our indebtedness.

Other Expense (Income), Net

Other expense (income), net consists primarily of the revaluation related to our convertible preferred stock warrants, which were accounted for as a liability prior to their conversion into common stock warrants on July 2, 2018 and marked-to-market at each reporting period, as well as interest income earned on our money market account balances, and non-utilization fees paid to Oxford related to our decision not to borrow the Term C Loan. Upon the closing of our IPO on July 2, 2018, all of our outstanding convertible preferred stock warrants converted into warrants to acquire an aggregate of 0.1 million shares of our common stock, resulting in the reclassification of the convertible preferred stock warrant liability into additional paid-in capital.

Results of Operations

Comparison of the Three Months ended September 30, 2019 and 2018

	Three Months Ended September 30,		Increase / (Decrease)	
	2019	2018	Dollars	Percentage
	(in thousands, except percentages)			
Revenues	\$ 16,000	\$ 13,737	\$ 2,263	16%
Cost of revenues	4,192	3,034	1,158	38%
Gross Profit	11,808	10,703	1,105	10%
Gross Margin	73.8%	77.9%		
Operating expenses:				
Sales and marketing	10,362	9,672	690	7%
General and administrative	4,285	3,238	1,047	32%
Research and development	3,489	2,125	1,364	64%
Total operating expenses	18,136	15,035	3,101	21%
Loss from Operations	(6,328)	(4,332)	(1,996)	-46%
Other (income) expense:				
Interest expense	930	928	2	0%
Other expense (income), net	(391)	(299)	(92)	-31%
Net Loss	\$ (6,867)	\$ (4,961)	\$ (1,906)	-38%

	Revenues by Geography Three Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
United States	\$ 15,294	96%	\$ 13,518	98%
International	706	4%	219	2%
Total revenues	\$ 16,000	100%	\$ 13,737	100%

	U.S. Revenues by Product Category Three Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
NeuroStar Advanced Therapy System	\$ 4,616	30%	\$ 3,908	29%
Treatment sessions	10,252	67%	9,218	68%
Other	426	3%	392	3%
Total U.S. revenues	\$ 15,294	100%	\$ 13,518	100%

Revenues

Total revenues increased by \$2.3 million, or 16%, from \$13.7 million for the three months ended September 30, 2018 to \$16.0 million for the three months ended September 30, 2019. Revenues in the United States increased by \$1.8 million for the three months ended September 30, 2019 compared to the three months ended September 30, 2018 due to higher unit sales of both NeuroStar Advanced Therapy Systems and treatment sessions. International revenues increased \$0.5 million for the three months ended September 30, 2019 compared to the three months ended September 30, 2018 due to a multi-unit order in Japan.

Revenues in the United States increased by \$1.8 million, or 13%, from \$13.5 million for the three months ended September 30, 2018 to \$15.3 million for the three months ended September 30, 2019. NeuroStar Advanced Therapy System revenues in the United States grew by \$0.7 million, or 18%, in the three months ended September 30, 2019 compared to the three months ended September 30, 2018. The increase was primarily driven by an approximate 240% increase in other NeuroStar revenue due to higher sales-type lease revenue as compared to the third quarter of 2018. This increase was partially offset by lower capital revenue as capital units sold decreased by 6% and average selling price declined 10% as compared to the prior period. On a sequential quarterly basis, average selling prices for capital sales were down approximately 3%.

NeuroStar Advanced Therapy System revenues represented 30% and 29% of U.S. revenues for the three months ended September 30, 2019 and 2018, respectively. We believe the growth in NeuroStar Advanced Therapy System revenues between these two periods was the result of the efforts of our expanded commercial organization and increased marketing efforts. As of September 30, 2019, we had an installed base of 1,032 active systems in the United States, compared to 858 as of September 30, 2018.

Treatment session revenues in the United States represented 67% and 68% of total revenues in the United States for the three months ended September 30, 2019 and 2018, respectively, and increased by 11% from \$9.2 million for the three months ended September 30, 2018 to \$10.3 million for the three months ended September 30, 2019. The increase in United States treatment session revenues was primarily the result of an approximate 8% increase in the number of treatment sessions sold and an approximate 170% increase in other treatment session revenue. This revenue increase was partially offset by an approximate 6% decline in the average treatment session selling price as a result of pre-determined volume pricing discounts within our existing customer base that are triggered when those customers surpass certain high-volume thresholds.

Cost of Revenues and Gross Margin

Cost of revenues increased by \$1.2 million, or 38%, from \$3.0 million for the three months ended September 30, 2018 to \$4.2 million for the three months ended September 30, 2019. The increase was primarily due to increased costs associated with increased NeuroStar Advanced Therapy System sales volumes. Gross margin decreased from 77.9% for the three months ended September 30, 2018 to 73.8% for the three months ended September 30, 2019. The decrease in gross margin was the result of a higher mix of NeuroStar Advanced Therapy revenue and the selling price decreases noted above.

Sales and Marketing Expenses

Sales and marketing expenses increased by \$0.7 million, or 7%, from \$9.7 million for the three months ended September 30, 2018 to \$10.4 million for the three months ended September 30, 2019. The increase was primarily due to increased personnel costs as a result of our sales expansion activities, as well as marketing expenses, consistent with our growth in revenues. Sales commissions were favorably impacted by \$1.3 million for the three months ended September 30, 2019 due to the Company's Topic 606 implementation as compared to the three months ended September 30, 2018.

General and Administrative Expenses

General and administrative expenses increased by \$1.0 million, or 32%, from \$3.2 million for the three months ended September 30, 2018 to \$4.3 million for the three months ended September 30, 2019. The increase was primarily due to an increase in personnel and legal, accounting and other professional services expenses required to support the growth of our business and the infrastructure for public company reporting.

Research and Development Expenses

Research and development expenses increased \$1.4 million, or 64%, from \$2.1 million for the three months ended September 30, 2018 to \$3.5 million for the three months ended September 30, 2019. The increase was primarily due to higher product development costs related to the launch of the next generation of our NeuroStar Advanced Therapy System and TrakStar practice management system, as well as increased spending in clinical development.

Interest Expense

Interest expense remained flat at \$0.9 million for the three months ended September 30, 2019 and 2018.

Other Expense (Income), Net

Other expense (income), net increased by \$0.1 million, from \$(0.3) million for the three months ended September 30, 2018 to \$(0.4) million for the three months ended September 30, 2019, primarily as a result of increased interest income earned on the Company's money market accounts and the final revaluation of the Company's warrants in the third quarter of 2018.

Comparison of the nine months ended September 30, 2019 and 2018

	Nine Months Ended September 30,		Increase / (Decrease)	
	2019	2018	Dollars	Percentage
	(in thousands, except percentages)			
Revenues	\$ 45,300	\$ 37,141	\$ 8,159	22%
Cost of revenues	11,170	8,736	2,434	28%
Gross Profit	34,130	28,405	5,725	20%
Gross Margin	75.3%	76.5%		
Operating expenses:				
Sales and marketing	31,477	27,616	3,861	14%
General and administrative	13,145	8,952	4,193	47%
Research and development	9,499	6,010	3,489	58%
Total operating expenses	54,121	42,578	11,543	27%
Loss from Operations	(19,991)	(14,173)	(5,818)	-41%
Other (income) expense:				
Interest expense	2,780	2,749	31	1%
Other expense (income), net	(1,281)	1,032	(2,313)	224%
Net Loss	\$ (21,490)	\$ (17,954)	\$ (3,536)	-20%

	Revenues by Geography Nine Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
United States	\$ 43,730	97%	\$ 36,388	98%
International	1,570	3%	753	2%
Total revenues	\$ 45,300	100%	\$ 37,141	100%

	U.S. Revenues by Product Category Nine Months Ended September 30,			
	2019		2018	
	Amount	% of Revenues	Amount	% of Revenues
	(in thousands, except percentages)			
NeuroStar Advanced Therapy System	\$ 12,594	29%	\$ 9,849	27%
Treatment sessions	29,877	68%	25,378	70%
Other	1,259	3%	1,161	3%
Total U.S. revenues	\$ 43,730	100%	\$ 36,388	100%

Revenues

Total revenues increased by \$8.2 million, or 22%, from \$37.1 million for the nine months ended September 30, 2018 to \$45.3 million for the nine months ended September 30, 2019. Revenues in the United States increased by \$7.3 million for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018 due to higher unit sales of both NeuroStar Advanced Therapy Systems and treatment sessions. International revenues increased for the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018, primarily due to a multi-unit order in Japan in the second quarter of 2019.

Revenues in the United States increased by \$7.3 million, or 20%, from \$36.4 million for the nine months ended September 30, 2018 to \$43.7 million for nine months ended September 30, 2019. NeuroStar Advanced Therapy System revenues in the United States grew by \$2.7 million, or 28%, in the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. The increase in U.S. NeuroStar revenue was driven by higher capital revenue, upgrade, and sales-type lease revenue. The increase in sales-type lease revenue was due to multi-unit orders in the United States in the third quarter of 2019. Capital units sold increased by 16% and average selling prices declined by 9% compared to the prior period.

NeuroStar Advanced Therapy System revenues represented 29% and 27% of U.S. revenues for the nine months ended September 30, 2019 and 2018, respectively. We believe the growth in NeuroStar Advanced Therapy System revenues between these two periods was the result of the efforts of our expanded commercial organization and increased marketing efforts. As of September 30, 2019, we had an installed base of 1,032 active systems in the United States, compared to 858 as of September 30, 2018.

Treatment session revenues in the United States represented 68% and 70% of total revenues in the United States for the nine months ended September 30, 2019 and 2018, respectively, and increased by 18% from \$25.4 million for the nine months ended September 30, 2018 to \$29.9 million for the nine months ended September 30, 2019. The increase in United States treatment session revenues was primarily the result of an approximate 17% increase in the number of treatment sessions sold and an increase in other treatment session revenue. This revenue increase was partially offset by an approximate 5% decline in average selling price as a result of certain volume pricing discounts within our existing customer base.

Cost of Revenues and Gross Margin

Cost of revenues increased by \$2.4 million, or 28%, from \$8.7 million for the nine months ended September 30, 2018 to \$11.2 million for the nine months ended September 30, 2019. The increase was primarily due to increased costs associated with NeuroStar Advanced Therapy System sales volumes. Gross margin decreased from 76.5% for the nine months ended September 30, 2018 compared to 75.3% for the nine months ended September 30, 2019. The change in gross margin was due to increased leveraged on our service and operations costs as a result of higher sales compared to the prior period, which were partially offset by the higher mix of NeuroStar Advanced Therapy revenues in 2019 in relation to treatment sessions revenues and the reduction in the average selling prices noted above.

Sales and Marketing Expenses

Sales and marketing expenses increased by \$3.9 million, or 14%, from \$27.6 million for the nine months ended September 30, 2018 to \$31.5 million for the nine months ended September 30, 2019. The increase was primarily due to increased personnel costs as a result of our sales and marketing expansion activities, as well as higher sales commissions and marketing expenses, consistent with our growth in revenues. Sales commissions were favorably impacted by \$2.9 million for the nine months ended September 30, 2019 due to the Company's Topic 606 implementation as compared to the nine months ended September 30, 2018.

General and Administrative Expenses

General and administrative expenses increased by \$4.2 million, or 47%, from \$9.0 million for the nine months ended September 30, 2018 compared to \$13.1 million for the nine months ended September 30, 2019. The increase was primarily due to an increase in personnel and legal, accounting and other professional services expenses required to support the growth of our business and the infrastructure for public company reporting.

Research and Development Expenses

Research and development expenses increased by \$3.5 million, or 58%, from \$6.0 million for the nine months ended September 30, 2018 compared to \$9.5 million the nine months ended September 30, 2019. The increase was primarily due to higher product development costs related to the launch of the next generation of our NeuroStar Advanced Therapy System and TrakStar practice management system, as well as increased spending in clinical development.

Interest Expense

Interest expense remained consistent at \$2.8 million for the nine months ended September 30, 2019 compared to \$2.7 million for the nine months ended September 30, 2018.

Other Expense (Income), Net

Other expense (income), net, increased by \$2.3 million, from \$1.0 million for the nine months ended September 30, 2018 to \$(1.3) million for the nine months ended September 30, 2019, primarily as a result of increased interest income earned on the Company's money market accounts and the final revaluation of the Company's warrants which occurred in the third quarter of 2018.

Liquidity and Capital Resources

Overview

On July 2, 2018, we closed our IPO, in which we issued and sold 6.325 million shares of our common stock, which included shares sold pursuant to an option granted to the underwriters to purchase additional shares, at a public offering price of \$17.00 per share. We received net proceeds of \$96.5 million after deducting underwriting discounts, commissions, and other offering expenses paid by us. Our common stock is listed on the Nasdaq Global Market under the trading symbol "STIM."

As of September 30, 2019, we had cash and cash equivalents of \$82.4 million and an accumulated deficit of \$242.5 million, compared to cash and cash equivalents of \$104.6 million and an accumulated deficit of \$221.0 million as of December 31, 2018. We incurred negative cash flows from operating activities of \$24.1 million and \$18.3 million for the nine months ended September 30, 2019 and September 30, 2018, respectively. We have incurred operating losses since our inception, and we anticipate that our operating losses will continue in the near term as we seek to expand our sales and marketing initiatives to support our growth in existing and new markets, invest funds in additional research and development activities and utilize cash for other corporate purposes. Our primary sources of capital to date have been from our IPO, private placements of our convertible preferred securities, borrowings under our credit facilities and sales of our products. As of September 30, 2019, we had \$30.0 million of borrowings outstanding under our credit facility, which matures in March 2022.

We expect our revenues and expenses to increase in connection with our on-going activities, particularly as we continue to execute on our growth strategy, including expansion of our sales and customer support teams. We also expect to incur additional costs now that we are a public company. Based on our current business plan, we believe that our cash and cash equivalents as of September 30, 2019 and anticipated revenues from sales of our products will be sufficient to meet our anticipated cash requirements for at least the next 24 months after September 30, 2019. However, if these sources are insufficient to satisfy our liquidity requirements, we may seek to sell additional common or preferred equity or debt securities or enter into a new credit facility or another form of third-party funding or seek other debt financing. If we raise additional funds by issuing equity or equity-linked securities, our stockholders would experience dilution and any new equity securities could have rights, preferences and privileges superior to those of holders of our common stock. Debt financing, if available, may involve covenants restricting our operations or our ability to incur additional debt. We cannot be assured that additional equity, equity-linked or debt financing will be available on terms favorable to us or our stockholders, or at all. It is also possible that we may allocate significant amounts of capital towards products or technologies for which market demand is lower than expected and, as a result, abandon such efforts. If we are unable to obtain adequate financing when we require it, or if we obtain financing on terms which are not favorable to us, or if we expend capital on products or technologies that are unsuccessful, our ability to continue to support our business growth and to respond to business challenges could be significantly limited, or we may be required to delay the development, commercialization and marketing of our products.

Our current and future funding requirements will depend on many factors, including:

- our ability to achieve revenue growth and improve operating margins;
- the cost of expanding our operations and offerings, including our sales and marketing efforts;
- our ability to improve or maintain coverage and reimbursement arrangements with domestic third-party and government payors, particularly in Japan;
- our rate of progress in establishing coverage and reimbursement arrangements from international commercial third-party and government payors;
- our rate of progress in, and cost of the sales and marketing activities associated with, establishing adoption of our products and maintaining or improving our sales to our current customers;
- the cost of research and development activities, including research and development relating to additional indications, which may include bipolar depression and PTSD;
- the effect of competing technological and market developments;
- costs related to international expansion; and
- the potential cost of and delays in product development as a result of any regulatory oversight applicable to our products.

Cash Flows

The following table sets forth a summary of our cash flows for the nine months ended September 30, 2019 and 2018

	Nine Months Ended September 30,	
	2019	2018
	(in thousands)	
Net Cash Used in Operating Activities	\$ (24,079)	\$ (18,315)
Net Cash Used in Investing Activities	(454)	(650)
Net Cash Provided by Financing Activities	2,320	96,578
Net (Decrease) Increase in Cash and Cash Equivalents	<u>\$ (22,213)</u>	<u>\$ 77,613</u>

Net Cash Used in Operating Activities

Net cash used in operating activities for the nine months ended September 30, 2019 was \$24.1 million, consisting primarily of a net loss of \$21.5 million and a decrease in net operating liabilities of \$6.5 million, partially offset by non-cash charges of \$3.9 million. The decrease in net operating liabilities was primarily due to an increase in accounts receivable on increased sales, decreases in accounts payable and accrued expenses as a result of timing and the first quarter 2019 payments of 2018 incentive compensation and commissions accrued as of December 31, 2018. In addition, the Company's prepaid commission due to the Company's Topic 606 implementation also negatively impacted cash flows from operating activities. Non-cash charges consisted of depreciation and amortization, non-cash interest expense, share-based compensation, and the cost of rental units purchased by customers.

Net cash used in operating activities for the nine months ended September 30, 2018 was \$18.3 million, consisting primarily of a net loss of \$18.0 million and a decrease in net operating liabilities of \$4.6 million, partially offset by non-cash charges of \$4.2 million. The decrease in net operating liabilities was primarily due to a decrease in accrued expenses as a result of the first quarter 2018 payments of 2017 incentive compensation and commissions accrued as of December 31, 2017. Non-cash charges consisted of depreciation and amortization, non-cash interest expense, share-based compensation, the cost of rental units purchased by customers and the change in the fair value of the liability related to our then-outstanding convertible preferred stock warrants.

Net Cash Used in Investing Activities

Net cash used in investing activities for the nine months ended September 30, 2019 was \$0.5 million, compared to net cash used in investing activities for the nine months ended September 30, 2018 of \$0.7 million, in each case attributable to purchases of property and equipment and capitalized software costs.

Net Cash Provided by Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2019 was \$2.3 million, consisting of cash proceeds related to stock option exercises. Net cash provided by financing activities for the nine months ended September 30, 2018 was \$96.6 million, consisting primarily of net proceeds from our IPO.

Indebtedness

Credit Facility

In March 2017, we entered into a loan and security agreement with Oxford Finance LLC, or Oxford, for a credit facility that replaced its previous \$25.0 million credit facility with Oxford and which allowed it to borrow up to \$35.0 million in three tranches of term loans: a Term A Loan in the amount of \$25.0 million, which was drawn down immediately upon closing in March 2017, a Term B Loan in the amount of \$5.0 million, which was drawn down in December 2017, and a Term C Loan in the amount of \$5.0 million, which became available to us upon the achievement of \$45.0 million of trailing twelve month revenues during the second quarter of 2018. Upon achieving the required revenue milestone, we had 60 days to notify Oxford if we elected to borrow the Term C Loan. As a result of completing our IPO on July 2, 2018 and receiving the net proceeds therefrom, we elected not to borrow the additional \$5.0 million, and it is no longer available to us. Each term loan accrues interest from the date of borrowing through the date of repayment at a floating per annum rate of interest, which resets monthly and is equal to the greater of (a) 8.15% or (b) the 30-day U.S. LIBOR on the last business day of the month plus 7.38%. We were also required to issue to Oxford at the date of each borrowing warrants to purchase its Series F or later series of convertible preferred stock with a seven-year term and in an amount equal to 3.95% of the first \$5.0 million of each tranche borrowed. The credit facility matures and all amounts borrowed thereunder are due on March 1, 2022. As of September 30, 2019, we had borrowed and had outstanding an aggregate of \$30.0 million of principal under the credit facility.

The Term A Loan featured an interest-only period through March 2019, during which time we were required to make monthly interest payments, after which time we were required to make monthly payments of principal and interest based on a 36-month amortization schedule. However, due to the achievement of \$45.0 million of revenues during fiscal year 2018, the interest-only period was extended for an additional 12 months through March 2020, after which time we will be required to make monthly payments of principal and interest based on a 24-month amortization schedule. In connection with the drawdown of the Term A Loan, we issued to Oxford a warrant to purchase shares of its Series F convertible preferred stock. On July 2, 2018, this convertible preferred stock warrant converted into a warrant to purchase 20,303 shares of our common stock at an exercise price of \$9.73 per share. The warrant will expire in March 2024.

The Term B Loan featured an interest-only period through March 2019, during which time we were required to make monthly interest payments, after which time we were required to make monthly payments of principal and interest based on a 36-month amortization schedule. However, due to the achievement of \$45.0 million of revenues during the fiscal year 2018, the interest-only period was extended for an additional 12 months through March 2020, after which time we will be required to make monthly payments of principal and interest based on a 24-month amortization schedule. In connection with the drawdown of the Term B Loan, we issued to Oxford a warrant to purchase shares of our Series F convertible preferred stock. On July 2, 2018, this convertible preferred stock warrant converted into a warrant to purchase 20,303 shares of our common stock at an exercise price of \$9.73 per share. The warrant will expire in December 2024.

In addition to principal and interest payments due under the credit facility, we are required to make final payment fees to Oxford due upon the earlier of prepayment or maturity of each tranche, which increased as a result the extension of the interest-only period and are now equal to 8.5% and 7.5% of the principal amounts of the Term A and Term B Loans, respectively. We accrued the estimated final payment fees using the effective interest rate, with a charge to non-cash interest expense, over the term of borrowing for each tranche. As of December 31, 2018, the effective interest rates for the Term A and Term B Loans were 11.87% and 12.14%, respectively. If we prepay our term loans prior to their respective scheduled maturities, we will also be required to make prepayment fees to Oxford equal to 3% if prepaid on or before the first anniversary of funding, 2% if prepaid after the first and on or before the second anniversary of funding, or 1% if prepaid after the second anniversary of funding of the principal amounts borrowed.

Our obligations under the credit facility are secured by a first priority security interest in substantially all of its assets, other than our intellectual property. We agreed not to pledge or otherwise encumber any of its intellectual property. The loan and security agreement related to the credit facility includes a financial maintenance covenant that requires us to achieve at least 75% of its trailing 12-month forecasted revenues, as measured each month in accordance with a forecast that we provided to Oxford upon signing the agreement and future forecasts that we are required to deliver to Oxford each year for the life of the credit facility, as well as customary affirmative and negative covenants. We were in compliance with all of the covenants under its credit facility as of September 30, 2019.

The loan and security agreement related to the credit facility contains events of default, including, without limitation, events of default upon: (i) failure to make payment pursuant to the terms of the agreement; (ii) violation of covenants; (iii) material adverse changes to our business; (iv) attachment or levy on our assets or judicial restraint on its business; (v) insolvency; (vi) significant judgments, orders or decrees for payments by we not covered by insurance; (vii) incorrectness of representations and warranties; (viii) incurrence of subordinated debt; (ix) revocation of governmental approvals necessary for we to conduct its business; and (x) failure by we to maintain a valid and perfected lien on the collateral securing the borrowing. Based on a 24-month amortization of the outstanding principal amounts of the Term A and Term B Loans beginning on April 1, 2020 as discussed above, the following table sets forth by year our required future principal payments (in thousands):

<u>Year:</u>	<u>Principal Payments</u>
2019	\$ -
2020	11,250
2021	15,000
2022	3,750
Total principal payments	<u>\$ 30,000</u>

Cash and Non-Cash Interest Expense

For the three months ended September 30, 2019, we recognized interest expense of \$0.9 million, of which \$0.7 million was cash and \$0.2 million was non-cash interest expense related to the amortization of deferred financing costs and accrual of final payment fees. For the three months ended September 30, 2018, we recognized interest expense of \$0.9 million, of which \$0.7 million was cash and \$0.2 million was non-cash interest expense related to the amortization of deferred financing costs and accrual of final payment fees.

For the nine months ended September 30, 2019, we recognized interest expense of \$2.8 million, of which \$2.2 million was cash and \$0.6 million was non-cash interest expense related to the amortization of deferred financing costs and accrual of final payment fees. For the nine months ended September 30, 2018, we recognized interest expense of \$2.7 million, of which \$2.1 million was cash and \$0.6 million was non-cash interest expense related to the amortization of deferred financing costs and accrual of final payment fees.

Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet arrangements, partnerships or other relationships with unconsolidated entities, often referred to as structured finance or special-purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Commitments and Contractual Obligations

As of September 30, 2019, there was one significant change to our commitments and future minimum contractual obligations as set forth in our Form 10-K, filed with the SEC on March 5, 2019. We refer you to "Note 8. Leases" in this Quarterly Report on Form 10-Q for information regarding our lease agreements.

JOBS Act Accounting Election

We are an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act of 2012, or JOBS Act, and are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, or Securities Act, for complying with new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. We have elected to avail ourselves of this exemption from complying with new or revised accounting standards and, therefore, will not be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies. Section 107 of the JOBS Act provides that we can elect to opt out of the extended transition period at any time, which election is irrevocable.

Subject to certain conditions, as an emerging growth company, we may rely on certain of these exemptions, including without limitation (i) providing an auditor’s attestation report on our system of internal controls over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act and (ii) complying with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor’s report providing additional information about the audit and the financial statements, known as the auditor discussion and analysis. We will remain an emerging growth company until the earlier of (a) the last day of the fiscal year in which we have total annual gross revenue of \$1.07 billion or more; (b) the last day of the fiscal year following the fifth anniversary of the date of the completion of this offering; (c) the date on which we have issued more than \$1.0 billion in nonconvertible debt during the previous six years; or (d) the date on which we are deemed to be a large accelerated filer under the rules of the SEC.

Recent Accounting Pronouncements

We refer you to “Note 3. Summary of Significant Accounting Policies” and “Note 4. Recent Accounting Pronouncements” in “Notes to Interim Financial Statements” located in “Part I – FINANCIAL INFORMATION, Item 1. Financial Statements”.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our cash is held on deposit in demand accounts at a large financial institution in amounts in excess of the Federal Deposit Insurance Corporation, or FDIC, insurance coverage limit of \$250,000 per depositor, per FDIC-insured bank, per ownership category. We have reviewed the financial statements of this institution and believe it has sufficient assets and liquidity to conduct its operations in the ordinary course of business with little or no credit risk to us.

Financial instruments that potentially subject us to concentrations of credit risk principally consist of cash equivalents and accounts receivable. We limit our credit risk associated with cash equivalents by placing investments in highly-rated money market funds. We limit our credit risk with respect to accounts receivable by performing credit evaluations when deemed necessary, but we do not require collateral to secure amounts owed to us by our customers.

As discussed above in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources - Indebtedness” section of this Quarterly Report on Form 10-Q, our credit facility bears interest at a floating per annum rate of interest, which resets monthly and is equal to the greater of (a) 8.15% or (b) the 30 day U.S. LIBOR on the last business day of the month plus 7.38%. As a result, we are exposed to risks from changes in interest rates. We believe that a one-point increase in interest rates would have resulted in an approximate \$0.3 million increase to our interest expense for the year ended December 31, 2018.

Inflationary factors, such as increases in our cost of revenues and operating expenses, may adversely affect our operating results. Although we do not believe inflation has had a material impact on our financial condition, results of operations or cash flows to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain and increase our gross margin or decrease our operating expenses as a percentage of our revenues if our selling prices of our products do not increase as much or more than our costs increase.

We do not currently have any exposure to foreign currency fluctuations and do not engage in any hedging activities as part of our normal course of business.

Item 4. Controls and Procedures.**Evaluation of Disclosure Controls and Procedures**

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, or Exchange Act, refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. As required by Rules 13a-15(b) and 15d-15(b) of the Exchange Act, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2019.

As a result of becoming a public company, we will be required, under Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting beginning with our Annual Report on Form 10-K for the year ended December 31, 2019. This assessment will need to include disclosure of any material weaknesses identified by our management in our internal control over financial reporting. The SEC defines a material weakness as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company’s annual or interim financial statements will not be detected or prevented on a timely basis.

Inherent Limitations on Effectiveness of Controls and Procedures

Internal control over financial reporting may not prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are achieved. Further, the design of a control system must be balanced against resource constraints, and therefore the benefits of controls must be considered relative to their costs. Given the inherent limitations in all systems of controls, no evaluation of controls can provide absolute assurance all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions or the degree of compliance with policies or procedures may deteriorate. Accordingly, given the inherent limitations in a cost-effective system of internal control, financial statement misstatements due to error or fraud may occur and may not be detected. Our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance of achieving their objectives. We conduct periodic evaluations of our systems of controls to enhance, where necessary, our control policies and procedures.

Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2019, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) which materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

We are subject from time to time to various claims and legal actions arising during the ordinary course of our business. We believe that there are currently no claims or legal actions that would reasonably be expected to have a material adverse effect on our results of operations, financial condition, or cash flows.

Item 1A. Risk Factors.

You should carefully consider the information described in the “Risk Factors” section of the Company’s Form 10-K filed with the SEC on March 5, 2019. There have been no material changes to the risk factors described therein.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Recent Issuances of Unregistered Securities

None.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following is a list of exhibits filed as part of this Quarterly Report on Form 10-Q. Where so indicated, exhibits that were previously filed are incorporated by reference. For exhibits incorporated by reference, the location of the exhibit in the previous filing is indicated.

Exhibit Number	Description
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

** This certification is being furnished solely to accompany this Quarterly Report on Form 10-Q pursuant to 18 U.S.C Section 1350 and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing of the registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEURONETICS, INC.
(Registrant)

Date: November 5, 2019

By: /s/ Christopher Thatcher
Name: Christopher Thatcher
Title: President and Chief Executive Officer
(Principal Executive Officer)

Date: November 5, 2019

By: /s/ Stephen Furlong
Name: Stephen Furlong
Title: VP, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Christopher Thatcher, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2019 of Neuronetics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2019

By: /s/ Christopher Thatcher
Name: Christopher Thatcher
Title: President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Stephen Furlong, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2019 of Neuronetics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2019

By: /s/ Stephen Furlong
Name: Stephen Furlong
Title: VP, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Neuronetics, Inc. (the "Company") for the fiscal quarter ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 5, 2019

By: /s/ Christopher Thatcher
Name: Christopher Thatcher
Title: President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Neuronetics, Inc. (the "Company") for the fiscal quarter ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 5, 2019

By: /s/ Stephen Furlong
Name: Stephen Furlong
Title: VP, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)