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, 2016

OR

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

For the transition period from to

Commission file number: 001-37799

Tactile Systems Technology, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware **(State or Other Jurisdiction of Incorporation or Organization)**	**41-1801204** **(I.R.S. Employer Identification Number)**
1331 Tyler Street NE, Suite 200 **Minneapolis, Minnesota** **(Address of Principal Executive Offices)**	**55413** **(Zip Code)**

(612) 355-5100
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

As of November 10, 2016 there were 16,813,826 shares of common stock, $0.001 par value per share, outstanding.

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PART II—OTHER INFORMATION

Forward-Looking Information

All statements, other than statements of historical facts, contained in this Quarterly Report on Form 10-Q, including statements regarding our business, operations and financial performance and condition, as well as our plans, objectives and expectations for our business, operations and financial performance and condition, are forward-looking statements. In some cases, you can identify forward-looking statements by the following words: "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "might," "target," "ongoing," "plan," "potential," "predict," "project," "should," "will," "would," or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our results, levels of activity, performance or achievements to be materially different from the information expressed or implied by the forward-looking statements in this Quarterly Report on Form 10-Q. Forward-looking statements may include, among other things, statements relating to:

- our expectations regarding the potential market size and widespread adoption of our products;
- our ability to increase awareness of lymphedema and chronic venous insufficiency and to demonstrate the clinical and economic benefits of our solutions to clinicians and patients;
- developments and projections relating to our competitors or our industry;
- the expected growth in our business and our organization, including outside of the United States;
- our ability to achieve and maintain adequate levels of coverage or reimbursement for our products and the effect of a recent change to the level of Medicare coverage;
- our financial performance, our estimates of our expenses, future revenues, capital requirements and our needs for, or ability to obtain, additional financing;
- our ability to retain and recruit key personnel, including the continued development and expansion of our sales and marketing organization;
- our ability to obtain an adequate supply of components for our products from our third party suppliers;
- our ability to obtain and maintain intellectual property protection for our products or avoid claims of infringement;
- our ability to identify and develop new products;

- our compliance with extensive government regulation;

- the volatility of our stock price; and

- our expectations regarding the time during which we will be an emerging growth company under the JOBS Act.

You should read the matters described in "Risk Factors" and the other cautionary statements made in the final prospectus (the “Prospectus”) dated July 27, 2016 for our initial public offering filed with the Securities and Exchange Commission (the “SEC”) on July 28, 2016 and in this Quarterly Report on Form 10-Q. We cannot assure you that the forward-looking statements in this report will prove to be accurate and therefore you are encouraged not to place undue reliance on forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. You are urged to carefully review and consider the various disclosures made by us in this report and in other reports filed with the SEC that advise of the risks and factors that may affect our business. Other than as required by law, we undertake no obligation to update or revise these forward-looking statements, even though our situation may change in the future. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments that we may make.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

Tactile Systems Technology, Inc.
Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$ 39,294	$ 7,060
Accounts receivable, net	13,021	14,151
Inventories	6,248	5,781
Deferred income taxes	1,781	1,766
Prepaid expenses	808	602
Total current assets	61,152	29,360
Property and equipment, net	1,399	1,346
Other assets		
Patent costs, net	2,304	2,489
Medicare accounts receivable – long term	1,644	2,039
Deferred income taxes	387	402
Other non-current assets	50	1,337
Total other assets	4,385	6,267
Total assets	$ 66,936	$ 36,973
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	$ 4,808	$ 3,336
Accrued payroll and related taxes	4,250	3,355
Accrued expenses	1,212	916
Future product royalties	265	991
Income taxes payable	172	904
Total current liabilities	10,707	9,502
Long-term liabilities		
Deferred compensation	150	193
Total liabilities	10,857	9,695
Convertible preferred stock		
Series B convertible preferred stock; $0.001 par value, no shares authorized, issued or outstanding as of September 30, 2016 and 5,319,066 shares authorized and 2,733,468 shares issued and outstanding as of December 31, 2015	—	12,599
Series A convertible preferred stock; $0.001 par value, no shares authorized, issued or outstanding as of September 30, 2016 and 3,112,153 shares authorized and 3,108,589 shares issued and 3,061,488 shares outstanding as of December 31, 2015	—	20,328
Stockholders' equity (deficit)		
Preferred stock; $0.001 par value, 50,000,000 shares authorized and no shares issued and outstanding as of September 30, 2016	—	—
Common stock; $0.001 par value, 300,000,000 shares authorized, 16,812,655 shares issued and 16,746,645 shares outstanding as of September 30, 2016, and 14,184,175 shares authorized and 3,222,902 shares issued and outstanding as of December 31, 2015	17	3
Additional paid-in capital	61,214	—
Accumulated deficit	(5,152)	(5,652)
Total stockholders' equity (deficit)	56,079	(5,649)
Total liabilities and stockholders' equity (deficit)	$ 66,936	$ 36,973

See accompanying notes to the condensed consolidated financial statements.

Tactile Systems Technology, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

(In thousands, except share and per share data)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenues, net	$ 22,635	$ 16,820	$ 56,064	$ 41,712
Cost of goods sold	6,282	4,466	15,417	11,839
Gross profit	16,353	12,354	40,647	29,873
Operating expenses				
Sales and marketing	8,979	6,199	23,858	17,297
Research and development	1,285	1,094	3,314	2,922
Reimbursement, general and administrative	5,115	3,599	12,495	9,448
Total operating expenses	15,379	10,892	39,667	29,667
Income from operations	974	1,462	980	206
Other income	10	3	20	18
Income before income taxes	984	1,465	1,000	224
Income tax expense	492	589	500	90
Net income	492	876	500	134
Convertible preferred stock dividends	224	470	1,247	1,396
Allocation of undistributed earnings to preferred stockholders	99	262	—	—
Net income (loss) attributable to common stockholders	$ 169	$ 144	$ (747)	$ (1,262)
Net income (loss) per common share attributable to common stockholders				
Basic	$ 0.01	$ 0.05	$ (0.12)	$ (0.44)
Diluted	$ 0.01	$ 0.03	$ (0.12)	$ (0.44)
Weighted-average common shares used to compute net income (loss) per common share attributable to common stockholders				
Basic	12,253,877	3,148,294	6,317,875	2,854,112
Diluted	13,982,799	4,799,308	6,317,875	2,854,112

See accompanying notes to the condensed consolidated financial statements.

Tactile Systems Technology, Inc.
Condensed Consolidated Statements of Stockholders' Equity (Deficit)
(Unaudited)

(In thousands, except share data)	Series B Preferred Stock Shares	Series B Preferred Stock Amount	Series A Preferred Stock Shares	Series A Preferred Stock Amount	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Accumulated Deficit	Total
Balances, December 31, 2014	2,733,468	$ 11,894	3,061,488	$ 19,188	2,626,619	$ 3	$ 442	$ (6,872)	$ (6,427)
Stock-based compensation	—	—	—	—	—	—	232	—	232
Exercise of common stock options and warrants	—	—	—	—	596,283	5	862	—	867
Preferred stock dividends	—	534	—	862	—	—	(1,396)	—	(1,396)
Net income for the period	—	—	—	—	—	—	—	134	134
Balances, September 30, 2015	2,733,468	$ 12,428	3,061,488	$ 20,050	3,222,902	$ 8	$ 140	$ (6,738)	$ (6,590)
Balances, December 31, 2015	2,733,468	$ 12,599	3,061,488	$ 20,328	3,222,902	$ 3	$ —	$ (5,652)	$ (5,649)
Stock-based compensation	—	—	—	—	—	—	902	—	902
Exercise of common stock options	—	—	—	—	234,135	1	223	—	224
Preferred stock dividend	—	436	—	811	—	—	(1,247)	—	(1,247)
Sale of common stock from initial public offering, net of offering expenses	—	—	—	—	4,120,000	4	35,378	—	35,382
Preferred stock dividends paid in cash	—	—	—	(8,207)	—	—	—	—	—
Common stock issued in lieu of series B preferred stock dividend	—	—	—	—	956,842	1	(1)	—	—
Conversion of series B preferred stock to common stock	(2,733,468)	(13,035)	—	—	2,733,468	3	13,032	—	13,035
Conversion of series A preferred stock to common stock	—	—	(3,061,488)	(12,932)	3,190,985	3	12,929	—	12,932
Common stock issued for series A & B preferred stock liquidation preference	—	—	—	—	2,354,323	2	(2)	—	—
Net income for the period	—	—	—	—	—	—	—	500	500
Balances, September 30, 2016	—	$ —	—	$ —	16,812,655	$ 17	$ 61,214	$ (5,152)	$ 56,079

See accompanying notes to the condensed consolidated financial statements.

Tactile Systems Technology, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(In thousands)	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Cash flows from operating activities		
Net income	$ 500	$ 134
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	675	622
Deferred income taxes	—	90
Stock-based compensation expense	859	232
Deferred compensation	—	(6)
Change in allowance for doubtful accounts	465	250
Changes in assets and liabilities		
Accounts receivable	665	1,092
Inventories	(467)	(1,849)
Prepaid expenses and other non-current assets	(233)	(708)
Medicare accounts receivable – long-term	395	(704)
Accounts payable	1,695	1,053
Accrued payroll and related taxes	895	246
Accrued expenses and income taxes payable	(387)	(173)
Future product royalties	(726)	(445)
Net cash provided by (used in) operating activities	4,336	(166)
Cash flows from investing activities		
Purchases of property and equipment	(518)	(420)
Patent costs	(24)	(18)
Net cash used in investing activities	(542)	(438)
Cash flows from financing activities		
Payments on notes payable	—	(7)
Proceeds from exercise of common stock options and warrants	224	867
Dividends paid on preferred stock	(8,207)	—
Fees paid for IPO	(4,777)	—
Proceeds from IPO	41,200	—
Net cash provided by financing activities	28,440	860
Net change in cash and cash equivalents	32,234	256
Cash and cash equivalents – beginning of period	7,060	5,416
Cash and cash equivalents – end of period	$ 39,294	$ 5,672
Supplemental cash flow disclosure		
Cash paid for interest	$ —	$ —
Cash paid for taxes	$ 1,261	$ 226

See accompanying notes to the condensed consolidated financial statements.

Tactile Systems Technology, Inc.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Nature of Operations and Basis of Presentation

Nature of Operations

Tactile Systems Technology, Inc. ("we," "us," and "our") is the sole manufacturer and distributor of the Flexitouch and Entré Systems, medical devices that help control symptoms of lymphedema, a chronic and progressive medical condition that is often an unintended consequence of cancer treatment, and the ACTitouch System, a medical device used to treat venous leg ulcers and chronic venous insufficiency. We provide our products for use in the home and sell them through vascular, wound and lymphedema clinics throughout the United States. We do business as "Tactile Medical."

Basis of Presentation

Our accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including those which are normal and recurring) considered necessary for a fair presentation of the interim financial information have been included. The results for the nine months ended September 30, 2016 are not necessarily indicative of results to be expected for the year ending December 31, 2016, or for any other interim period or for any future year. Our business is affected by seasonality. In the first quarter of each year, when most patients have started a new insurance year and have not paid their annual deductibles, we experience substantially reduced demand for our products. We typically experience higher sales in the third and fourth quarters as a result of patients having paid their annual insurance deductibles in full, thereby reducing their out-of-pocket costs for our products, or because patients often spend the remaining balances in their flexible spending accounts. The condensed consolidated interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in our final prospectus dated July 27, 2016 filed with the SEC on July 28, 2016.

We were originally incorporated in Minnesota under the name Tactile Systems Technology, Inc. on January 30, 1995. During 2006, we established a merger corporation and subsequently, on July 21, 2006, merged with and into this merger corporation. The resulting corporation assumed the name Tactile Systems Technology, Inc. The purpose of this merger was to reincorporate the company in Delaware, increase the number of authorized common shares to 8.9 million and assign a par value of $0.001 to our common stock. In September 2013, we began doing business as "Tactile Medical."

In connection with preparing for our initial public offering, our board of directors and stockholders approved a one-for-2.820044 reverse stock split of our capital stock. The reverse stock split became effective in June 2016. All share and per share amounts in these financial statements and notes thereto have been retroactively adjusted for all periods presented to give effect to this reverse stock split, including reclassifying an amount equal to the reduction in par value of common stock to additional paid-in capital.

On August 2, 2016 we closed the initial public offering of our common stock, which resulted in the sale of 4,120,000 shares of our common stock at a public offering price of $10.00 per share. We received net proceeds from the initial public offering of approximately $35.4 million, after deducting underwriting discounts and approximately $2.9 million of transaction expenses. In connection with the closing of the initial public offering, all of our outstanding redeemable convertible preferred stock automatically converted to common stock on August 2, 2016. At August 2, 2016, we did not have any redeemable convertible preferred stock issued or outstanding. The significant increase in common stock outstanding in connection with the initial public offering is expected to impact the year-over-year comparability of our earnings per share calculations in future periods.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Tactile Systems Technology, Inc. and its wholly owned subsidiary, Swelling Solutions, Inc., after elimination of intercompany accounts and transactions.

JOBS Act Accounting Election

As an emerging growth company under the Jumpstart Our Business Startups ("JOBS") Act, we 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. We have elected to take advantage of the extended transition period for adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies.

Estimates

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We continue to refine our estimates of the Medicare and other accounts receivable and related revenue recognition based on information available to us related to historical approval rates.

Significant Accounting Policies

During the nine months ended September 30, 2016 there were no material changes in our significant accounting policies. See Note 1 to the condensed consolidated financial statements included in our final Prospectus dated July 27, 2016, filed with the SEC on July 28, 2016, for information regarding our significant accounting policies.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance creating Accounting Standards Codification ("ASC") Section 606, "Revenue from Contracts with Customers." The new section will replace Section 605, "Revenue Recognition," and creates modifications to various other revenue accounting standards for specialized transactions and industries. The section is intended to conform revenue accounting principles with a concurrently issued International Financial Reporting Standards to reconcile previously differing treatment between United States practices and those of the rest of the world and to enhance disclosures related to disaggregated revenue information. The updated guidance, which was amended July 9, 2015, is effective for annual reporting periods beginning on or after December 15, 2017, and interim periods within those annual periods. We will adopt the new provisions of this accounting standard at the beginning of fiscal year 2018, because early adoption is not allowed. We are currently evaluating the impact of this new standard on our consolidated financial statements.

In November 2015, the FASB issued Accounting Standards Update ("ASU") 2015-l7, "Income Taxes: Balance Sheet Classification of Deferred Taxes," which requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. The ASU is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for all entities. We are currently evaluating the impact of this new standard on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842), which supersedes the existing guidance for lease accounting, "Leases" (Topic 840). ASU 2016-02 requires lessees to recognize a lease liability and a right of use asset for all leases. Lessor accounting remains largely unchanged. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for all entities. ASU 2016-02 requires a modified retrospective approach for all leases existing at or entered into after the date of initial adoption, with an option to elect to use certain transition relief. We are currently evaluating the impact of this new standard on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes and statutory tax withholding requirements and classification within the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2016. We are currently evaluating the impact of this new standard on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses," to require the measurement of expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable forecasts. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. We are currently evaluating the impact of this new standard on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments," to provide clarity on how certain cash receipt and cash payment transactions are presented and classified within the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are currently evaluating the impact of this new standard on our consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents consist of all cash on hand, deposits and funds invested in available for sale securities with original maturities of three months or less at the time of purchase. At September 30, 2016, our cash was held primarily in checking and money market accounts.

Note 2. Patent Costs, Net

Our patents, all of which are subject to amortization, are summarized as follows:

(In thousands)	As of September 30, 2016	As of December 31, 2015
Patents	$ 3,428	$ 3,403
Less: accumulated amortization	(1,124)	(914)
Net patents	$ 2,304	$ 2,489

Amortization expense was $0.2 million for the nine-month periods ended September 30, 2016 and September 30, 2015, and $0.1 million for the three-month periods ended September 30, 2016 and September 30, 2015. Future amortization expenses are expected as follows:

(In thousands)	
2016 (October 1 - December 31)	$ 69
2017	279
2018	279
2019	279
2020	279
Thereafter	1,119
Total	$ 2,304

Note 3. Accrued Expenses

Accrued expenses consisted of the following:

(In thousands)	As of September 30, 2016	As of December 31, 2015
Accrued warranty	$ 540	$ 360
Accrued clinical	71	130
Other	601	426
Total	$ 1,212	$ 916

Note 4. Line of Credit — Bank

We have a $2.0 million line of credit with a bank that bears interest based on the prime rate, which was 3.50% as of September 30, 2016, and expires on May 11, 2017. Our credit line is secured by substantially all of our assets, including property and equipment, accounts receivable and inventory. Our credit line contains customary conditions as to borrowing, events of default and covenants, including covenants that restrict our ability to dispose of assets, merge with or acquire other entities, and incur indebtedness or encumbrances. There was no outstanding balance on the line of credit as of September 30, 2016 or as of December 31, 2015.

Note 5. Commitments and Contingencies

Lease Obligations

In March 2008, we entered into a non-cancelable operating lease agreement for building space for our corporate headquarters that provides for monthly rent, real estate taxes and operating expenses that was extended to July 31, 2021. Rent expense was $0.6 million for both the nine-month periods ended September 30, 2016 and September 30, 2015, and $0.2 million for both the three-month periods ended September 30, 2016 and September 30, 2015.

In July 2016, we entered into a non-cancelable operating lease agreement for building space to accommodate the relocation of our manufacturing, quality, and research and development functions. The lease agreement extends through October 2021 and provides for monthly rent, real estate taxes and operating expenses. Because we did not take possession of this leased facility prior to September 30, 2016, no associated rent expense has been recorded in our statement of operations as of September 30, 2016.

We also have operating lease agreements for certain computer and office equipment that expire in 2020. The leases provide an option to purchase the related equipment at fair market value at the end of the lease.

Future base minimum lease payments for all lease obligations are expected to be as follows for the years ending December 31:

(In thousands)	Building	Computer/Office Equipment	Total
2016 (October 1 - December 31)	$ 154	$ 5	$ 159
2017	695	20	715
2018	714	18	732
2019	733	11	744
2020	753	1	754
Thereafter	506	—	506
Total	$ 3,555	$ 55	$ 3,610

Major Vendors

We had purchases from three vendors that accounted for 36% and 45% of total purchases for the nine-month periods ended September 30, 2016 and September 30, 2015, respectively, and 35% of total purchases for each of the three-month periods ended September 30, 2016 and September 30, 2015.

Purchase Commitment

We issued purchase orders in February 2016 totaling $7.6 million for inventory that we expect to receive between October 2016 and July 2017.

Employment Agreements

We have entered into employment agreements with certain of our officers. The agreements provide for payment of severance ranging from nine to 15 months of then-current annualized base salary in the event of termination by us without cause or by the employee for good reason or, in the case of two of the officers, death, disability, or as a result of a qualifying termination after a change in control. The agreements also provide for payment of an amount equal to nine to 15 months of the then-current annual target bonus in the event of termination by us without cause or by the employee for good reason, or, in the case of two of the officers, death, disability, or as a result of a qualifying termination after a change in control. In addition, the agreements provide for the vesting of certain equity compensation through the date of termination in the event of termination by us without cause or by the employee for good reason.

Deferred Compensation

Deferred compensation consisted of 66,010 shares of restricted common stock as of September 30, 2016. These shares of restricted common stock were issued upon the conversion of 45,523 shares of restricted Series A preferred stock outstanding immediately prior to the completion of our initial public offering. The restricted shares vest upon the earlier of a change in control, as defined in the restricted stock agreement, or May 2, 2017.

Retirement Plan

We maintain a 401(k) retirement plan for our employees in which eligible employees can contribute a percentage of their pre-tax compensation. We may also make discretionary contributions to the 401(k) plan. We made contributions of $120,000 and $100,000 for the nine-month periods ended September 30, 2016 and September 30, 2015, respectively, and $45,000 and $36,000 for the three-month periods ended September 30, 2016 and September 30, 2015, respectively.

Note 6. Stockholders' Equity

In September and October 2012, we received gross proceeds of $10.4 million for issuance of 2,733,468 shares of our Series B preferred stock at $3.80 per share. The Series B preferred stock included a liquidation preference of the original investment plus an accruing dividend at a rate of 6%, compounded annually, whether or not declared. The accruing dividend was payable upon a voluntary or involuntary liquidation or dissolution of our company, upon conversion of the Series B preferred stock to common stock, upon redemption of the Series B preferred stock or at such time as we paid a dividend on other shares of our capital stock. The accruing dividend could have been paid in cash or, at the option of the stockholder, additional shares of Series B preferred stock determined by dividing the amount of the accruing dividend by the Series B preferred stock purchase price as adjusted. There were $2.6 million of undeclared cumulative preferred dividends as of August 2, 2016, the date we closed our initial public offering and paid those dividends in the form of shares of our common stock. Holders of shares of Series B preferred stock were entitled to votes equal to the number of shares of common stock into which such Series B preferred stock could be converted.

Each share of Series B preferred stock could be converted into equal shares of common stock at the option of the Series B preferred stock holder at any time. In addition, the Series B preferred stock shares were automatically convertible into common shares upon the sale of shares of common stock to the public at a price per share of at least $11.42 in a firm commitment underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, resulting in at least $30 million of proceeds to our company, net of underwriting discounts and commissions and after which the common stock is listed on an United States national securities exchange. Each Series B Preferred stockholder was also entitled to receive the number of common shares equal to the Series B preferred stock original issue price divided by the initial public offering price per share. In addition, each Series B Preferred stockholder was entitled to receive the number of common shares equal to (1) the accrued dividends on the shares of Series B preferred stock divided by the original issue price of the Series B preferred stock and (2) the accrued dividends on the shares of Series B preferred stock divided by the initial public offering price per share in the offering.

From 2007 through 2009, we received gross proceeds of $13.0 million for the issuance of 3,061,488 shares of our Series A preferred stock at $4.23 per share. The Series A preferred stock included a liquidation preference of the original investment plus an accruing dividend at a rate of 6%, compounded annually, whether or not declared. The accruing dividend was payable upon a voluntary or involuntary liquidation or dissolution of our company or upon conversion of the Series A preferred stock to common stock, upon redemption of the Series A preferred stock or at such time as we paid a dividend on other shares of our capital stock. The accruing dividend would be paid in cash. There were $8.2 million of undeclared cumulative preferred dividends as of August 2, 2016, the date we closed our initial public offering and paid those dividends in cash. Holders of shares of Series A preferred stock were entitled to votes equal to the number of shares of common stock into which such Series A preferred stock could be converted. Purchasers of the Series A preferred stock received anti-dilution rights whereby if we issued or sold additional shares of preferred or common shares at a purchase price below $4.23 per share, we would issue additional shares to these purchasers of Series A preferred stock to effectively reduce their purchase price. The Series B preferred stock was sold at a price less than the Series A preferred stock. As a result, we issued 83,972 shares of common stock for this anti-dilution provision.

Each share of Series A preferred stock could be converted into equal shares of common stock at the option of the Series A preferred stock holder at any time. In addition, the Series A preferred stock shares were automatically convertible into common shares upon the sale of shares of common stock to the public at a minimum price of $11.42 per share in a firm commitment underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, resulting in at least $30 million of proceeds to our company, net of underwriting discounts and commissions. Each Series A Preferred stockholder was also entitled to receive the number of common shares equal to the Series A preferred stock original issue price divided by the initial public offering price per share.

At the time of its issuance, we determined that the Series B and Series A preferred stock contained two embedded features: (1) optional redemption by the holder and (2) optional conversion by the holder. We determined that each of the embedded features met the definition of a derivative and that the Series B and Series A preferred stock should be considered an equity host for the purposes of assessing the embedded derivatives for potential bifurcation. The following was noted regarding these embedded features:

Optional Redemption by the Holder. We determined that the redemption feature was not clearly and closely related to the equity host instrument but does not meet the definition of a derivative. As such, the redemption feature did not require bifurcation under the guidance for derivatives.

Optional Conversion by the Holder. The optional conversion feature was determined to be clearly and closely related to the Series B and Series A preferred stock host. As such the conversion feature did not require bifurcation under ASC 815-"Derivatives and Hedging".

The Series B and Series A preferred stock was assessed under ASC 470, "Debt," to determine if there was a beneficial conversion feature. We determined there was no beneficial conversion feature.

We completed the initial public offering of our common stock on August 2, 2016, in which we sold 4,120,000 shares of our common stock at a public offering price of $10.00 per share. Immediately prior to the completion of the initial public offering, all then-outstanding shares of our Series A and Series B preferred stock were converted into 5,924,453 shares of our common stock. Our Series A preferred stock converted to common stock at a ratio of 1-for-1.03 and our Series B preferred stock converted to common stock at a ratio of 1-for-1. In addition, immediately prior to the completion of the initial public offering, we issued 2,354,323 additional shares of our common stock that our Series A and Series B preferred stockholders were entitled to receive in connection with the conversion of the preferred stock, and we issued 956,842 shares of our common stock to pay accrued dividends on our Series B preferred stock. We also paid $8.2 million in cumulative accrued dividends to our Series A convertible preferred stockholders in conncection with the initial public offering, including $0.1 million of dividends paid to the holders of the common restricted shares.

Stock-Based Compensation

Our equity compensation plans provide for the grant of incentive and nonqualified stock options, as well as other stock-based awards, including restricted stock and restricted stock units, to employees, non-employee directors and other consultants who provide services to us. Restricted stock awards result in the issuance of new shares when granted. For other stock-based awards, new shares are issued when the award is exercised, vested or released according to the terms of the agreement.

In June 2016, we adopted the 2016 Equity Incentive Plan (the “2016 Plan”), pursuant to which an aggregate of 4.8 million shares of our common stock may be awarded to employees, directors and consultants as equity awards in the form of stock grants, restricted stock awards, stock options, restricted stock units, performance shares and other equity awards. With the adoption of the 2016 Plan, the board of directors decided we would no longer grant any options under our other existing equity compensation plans. At September 30, 2016, there were 4.5 million shares remaining available for grant under the 2016 Plan.

We recorded stock-based compensation expense of $0.7 million and $0.9 million for the three-month and nine-month periods ended September 30, 2016, respectively, and $0.1 million and $0.2 million for the three-month and nine-month periods ended September 30, 2015, respectively. This expense was allocated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
(In thousands)				
Cost of goods sold	$ 33	$ 21	$ 71	$ 52
Sales and marketing	188	47	272	125
Research and development	14	—	14	—
Reimbursement, general and administrative	474	19	502	55
Total stock-based compensation expense	$ 709	$ 87	$ 859	$ 232

Stock Options

We have granted stock option awards which generally vest over four years and have a contractual term of ten years from the date of grant. Our stock option activity was as follows:

	Options (#)	Weighted Average Exercise Price ($/share)
Outstanding at December 31, 2015	1,840,448	$ 1.18
Granted	305,236	10.60
Exercised	(234,948)	0.95
Forfeited	(23,535)	2.84
Outstanding at September 30, 2016	1,887,201	$ 2.33

Of the total outstanding options at September 30, 2016, 1,283,036 were exercisable with a weighted average exercise price of $1.02 per share. The total outstanding options had a weighted average remaining contractual life of 5.7 years.

At September 30, 2016, there was approximately $2.0 million of unrecognized stock option expense under our equity compensation plans, which is expected to be recognized on a straight-line basis over a weighted average period of 2.7 years.

Restricted Stock Units

In conjunction with our initial public offering, we granted 307,594 restricted stock units ("RSUs") under the 2016 Plan to executives, other employees and non-employee directors, which RSUs had an aggregate grant date fair value of $3.1 million. These RSUs include only a time-based service condition. The compensation expense of these RSUs was determined using the fair value of the company's common stock on the date of grant, and compensation expense will be recognized on a straight-line basis over the requisite vesting period. At September 30, 2016, there was $2.9 million of total unrecognized compensation expense related to these unvested RSUs, which is expected be recognized over a weighted average period of 2.5 years.

Employee Stock Purchase Plan

Our employee stock purchase plan ("ESPP"), which was approved by our board of directors on April 27, 2016 and by our stockholders on June 20, 2016, allows participating employees to purchase shares of our common stock at a discount through payroll deductions. The plan is available to all of our employees and employees of participating subsidiaries. Participating employees may purchase common stock, on a voluntary after tax-basis, at a price equal to 85% of the lower of the closing market price per share of our common stock on the first or last trading day of each stock purchase period. The plan ordinarily consists of six-month purchase periods, beginning on May 16 and November 16 of each calendar year, but the initial purchase period began on July 27, 2016 and will end on May 15, 2017. A total of 1.6 million shares of common stock are reserved for issuance under the plan, and this share reserve will automatically be supplemented each January 1 through the year 2026 by an amount equal to the least of (1) 1% of the shares of our common stock outstanding on the immediately preceding December 31, (2) 500,000 shares or (3) such lesser amount as our board of directors may determine. No purchases were made under the plan in the nine months ended September 30, 2016. We recognized $0.2 million in stock-based compensation expense related to the ESPP for each of the three-month and nine-month periods ended September 30, 2016. We did not recognize any stock-based compensation expense related to the ESPP in either of the three-month or nine-month periods ended September 30, 2015.

Note 7. Income Taxes

We record our interim provision for income taxes by applying our estimated annual effective tax rate to our year-to-date pre-tax income and adjust the provision for discrete tax items recorded in the period. Deferred income taxes result from temporary differences between the reporting of amounts for financial statement purposes and income tax purposes. These differences relate primarily to different methods used for income tax purposes including depreciation and amortization, warranty and vacation accruals, and deductions related to allowances for doubtful accounts receivable and inventory reserves.

We recorded income tax expense of $0.5 million for the three-month and nine-month periods ended September 30, 2016, respectively. We recorded income tax expense of $0.6 million and $0.1 million for the three-month and nine-month periods ended September 30, 2015, respectively. Our provisions for income taxes included current federal and state income tax expense, as well as deferred federal and state income tax expense.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the condensed consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

With few exceptions, we are no longer subject to U.S. federal, state or local income tax examinations by tax authorities for the years before 2011. We are not currently under examination by any taxing jurisdiction. In the event of any future tax assessments, we have elected to record the income taxes and any related interest and penalties as income tax expense on our statement of operations.

Note 8. Net Income (Loss) Per Share Attributable to Common Stockholders

The following table sets forth the computation of our basic and diluted net income (loss) per share attributable to common stockholders:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
(In thousands, except per share data)				
Net income	$ 492	$ 876	$ 500	$ 134
Convertible preferred stock dividends	224	470	1,247	1,396
Allocation of undistributed earnings to preferred stockholders	99	262	—	—
Net income (loss) attributable to common stockholders	$ 169	$ 144	$ (747)	$ (1,262)
Weighted average shares outstanding	12,253,877	3,148,294	6,317,875	2,854,112
Effect of common stock options, warrants, restricted stock units and employee stock purchase plan shares	1,728,922	1,651,014	—	—
Weighted-average shares used to compute diluted net income (loss) per share	13,982,799	4,799,308	6,317,875	2,854,112
Net income (loss) per share - Basic	$ 0.01	$ 0.05	$ (0.12)	$ (0.44)
Net income (loss) per share - Diluted	$ 0.01	$ 0.03	$ (0.12)	$ (0.44)

As of September 30, 2016, total common shares outstanding and the potentially dilutive shares totaled approximately 18.5 million shares.

The following potentially dilutive securities were excluded from the computation of weighted shares outstanding for the three-month and nine-month periods ended September 30, 2016 and September 30, 2015 because these securities would have had an anti-dilutive impact:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Convertible preferred stock outstanding	—	—	—	5,794,958
Restricted stock units	—	—	373,604	—
Common stock options	31,016	—	1,887,201	1,861,709
Employee stock purchase plan shares	—	—	35,821	—
Common stock warrants	—	—	5,800	14,518
Total	31,016	—	2,302,426	7,671,185

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 should be read in conjunction with our condensed consolidated financial statements and the accompanying notes thereto included elsewhere in this report.

Overview

We are a medical technology company that develops and provides innovative medical devices for the treatment of chronic diseases at home. We focus on advancing the standard of care in treating chronic diseases in the home setting to improve patient outcomes and quality of life and help control rising healthcare expenditures. We possess a unique, scalable platform to deliver at-home healthcare solutions throughout the United States. This evolving home care delivery model is recognized by policy-makers and payers as a key for controlling rising healthcare expenditures. Our initial area of therapeutic focus is vascular disease, with a goal of advancing the standard of care in treating lymphedema and chronic venous insufficiency. Our solutions deliver cost-effective, clinically proven, long-term treatment for these chronic diseases.

Our proprietary products are the Flexitouch System, the Entré System, and the ACTitouch System. A predecessor to our Flexitouch System received 510(k) clearance from the U.S. Food and Drug Administration (the "FDA") in July 2002, and we introduced the system to address the many limitations of self-administered home-based manual lymphatic drainage therapy. We began selling our more advanced Flexitouch System after receiving 510(k) clearance from the FDA in October 2006. Historically, we derived substantially all of our revenues from our Flexitouch System. For the nine months ended September 30, 2016 and 2015, sales of our Flexitouch System represented 86% and 87% of our revenues, respectively. In September 2016, we received 510(k) clearance from the FDA for the Flexitouch System in treating lymphedema of the head and neck.

In September 2012, we acquired our second proprietary product, the ACTitouch System. The system received 510(k) clearance from the FDA in June 2013, and we began selling the product in September 2013 to address the many limitations of non-removable multilayered bandages that are worn by patients suffering from venous leg ulcers. We also introduced our Entré System in the United States in February 2013. The Entré System is sold to patients for whom a more basic pump is suitable or who do not yet qualify for insurance reimbursement for an advanced compression device such as our Flexitouch System. For the nine months ended September 30, 2016 and 2015, sales of our ACTitouch and Entré Systems combined represented 14% and 13% of revenues, respectively.

To support the growth of our business, we invest heavily in our commercial infrastructure, consisting of our direct sales force, home training resources, reimbursement capabilities and clinical expertise. We market our products in the United States using a direct-to-patient and -provider model. Our direct sales force has grown from three representatives in March 2005 to a team of over 110 people as of September 30, 2016. This model allows us to directly approach patients and clinicians, whereby we disintermediate the traditional durable medical equipment channel, allowing us to capture both the manufacturer and distributor margins. We also utilize over 300 licensed, independent healthcare practitioners as home trainers who educate patients on the proper use of our systems. We invest substantial resources in our reimbursement operations group of over 65 people that focuses on verifying case-by-case benefits, obtaining prior authorization, billing and collecting payments from payers and providing customer support services. Our payer relations group of over 25 people is responsible for developing relationships with payer decision-makers to educate them on our product efficacy, develop overall payer coverage policies and reimbursement criteria, manage Medicare patient claims and contracts with payers, and serve as an advocacy liaison between patients, clinicians and payers throughout the appeals process. We also have a clinical team, consisting of a scientific advisory board, in-house therapists and nurses, and a medical director (part-time), that serves as a resource to clinicians and patients and guides our development of clinical evidence in support of our products.

Our patients are reimbursed by government and private payers for the purchase of our products pursuant to established rates with each payer. We rely on third-party contract manufacturers for the sourcing of parts, the assembly of our controllers and the manufacturing of the garments used with our systems. We conduct final assembly of the garments used with our Flexitouch System, perform quality assurance, and ship our products from our facility in Minneapolis, Minnesota.

For the three months ended September 30, 2016, we generated revenues of $22.6 million and had net income of $0.5 million, compared to revenues of $16.8 million and net income of $0.9 million for the three months ended

September 30, 2015. For the nine months ended September 30, 2016, we generated revenues of $56.1 million and net income of $0.5 million, compared to revenues of $41.7 million and net income of $0.1 million for the nine months ended September 30, 2015. Our primary sources of capital to date have been from operating income and private placements of our capital stock, as well as our initial public offering, which closed on August 2, 2016. We operate in one segment for financial reporting purposes.

Results of Operations

Comparison of the Three and Nine Months Ended September 30, 2016 and 2015

The following table presents our results of operations for the periods indicated.

	Three Months Ended September 30,				Change	
	2016		2015			
(In thousands, except percentages)		% of revenue		% of revenue	$	%
Condensed Consolidated Statement of Operations Data:						
Revenues	$ 22,635	100 %	$ 16,820	100 %	$ 5,815	35 %
Cost of goods sold	6,282	28	4,466	27	1,816	41
Gross profit	16,353	72	12,354	73	3,999	32
Operating expenses						
Sales and marketing	8,979	40	6,199	37	2,780	45
Research and development	1,285	6	1,094	7	191	17
Reimbursement, general and administrative	5,115	23	3,599	21	1,516	42
Total operating expenses	15,379	68	10,892	65	4,487	41
Income from operations	974	4	1,462	9	(488)	(33)
Other income	10		3		7	233
Income before income taxes	984		1,465		(481)	(33)
Income tax expense	492		589		(97)	(16)
Net income	$ 492		$ 876		$ (384)	(44)

	Nine Months Ended September 30,				Change	
	2016		2015			
(In thousands, except percentages)		% of revenue		% of revenue	$	%
Condensed Consolidated Statement of Operations Data:						
Revenues	$ 56,064	100 %	$ 41,712	100 %	$ 14,352	34 %
Cost of goods sold	15,417	27	11,839	28	3,578	30
Gross profit	40,647	73	29,873	72	10,774	36
Operating expenses						
Sales and marketing	23,858	43	17,297	41	6,561	38
Research and development	3,314	6	2,922	7	392	13
Reimbursement, general and administrative	12,495	22	9,448	23	3,047	32
Total operating expenses	39,667	71	29,667	71	10,000	34
Income from operations	980	2	206	-	774	376
Other income	20		18		2	11
Income before income taxes	1,000		224		776	346
Income tax expense	500		90		410	456
Net income	$ 500		$ 134		$ 366	273

Revenues

Revenues increased $5.8 million, or 35%, to $22.6 million in the three months ended September 30, 2016, compared to $16.8 million in the three months ended September 30, 2015. Revenues increased $14.4 million, or 34%, to $56.1 million in the nine months ended September 30, 2016, compared to $41.7 million in the nine months ended September 30, 2015. The growth in revenues was primarily attributable to an increase of approximately $4.8 million, or 33%, in sales of our Flexitouch System in the three months ended September 30, 2016, and an increase of approximately

$11.9 million, or 33%, in sales of our Flexitouch System in the nine months ended September 30, 2016, in each case compared to the same prior year period. These increases in Flexitouch sales were driven primarily by expansion of our sales force, increased physician and patient awareness of the lymphedema condition, and increased contractual coverage with national and regional insurance payers.

The following table summarizes our revenues by product for the three and nine months ended September 30, 2016 and September 30, 2015, both in dollars and percentage of total revenues:

	Three Months Ended September 30,		
	2016	2015	% Change
(In thousands, except percentages)			
Revenues			
Flexitouch System	$ 19,387	$ 14,609	33 %
ACTitouch/Entré Systems	3,248	2,211	47 %
Total	$ 22,635	$ 16,820	35 %
Percentage of total revenues			
Flexitouch System	86 %	87 %	
ACTitouch/Entré Systems	14 %	13 %	
Total	100 %	100 %	

	Nine Months Ended September 30,		
	2016	2015	% Change
(In thousands, except percentages)			
Revenues			
Flexitouch System	$ 47,988	$ 36,098	33 %
ACTitouch/Entré Systems	8,076	5,614	44 %
Total	$ 56,064	$ 41,712	34 %
Percentage of total revenues			
Flexitouch System	86 %	87 %	
ACTitouch/Entré Systems	14 %	13 %	
Total	100 %	100 %	

Our business is affected by seasonality. In the first quarter of each year, when most patients have started a new insurance year and have not paid their annual deductibles, we experience substantially reduced demand for our products. We typically experience higher sales in the third and fourth quarters as a result of patients having paid their annual insurance deductibles in full, thereby reducing their out-of-pocket costs for our products, or because patients often spend the remaining balances in their flexible spending accounts.

Cost of Goods Sold and Gross Margin

Cost of goods sold increased $1.8 million, or 41%, to $6.3 million during the three months ended September 30, 2016, compared to $4.5 million during the three months ended September 30, 2015. Cost of goods sold increased $3.6 million, or 30%, to $15.4 million during the nine months ended September 30, 2016, compared to $11.8 million during the nine months ended September 30, 2015. The increase in cost of goods sold in each of the 2016 periods was primarily attributable to an increase in the number of systems sold.

Gross margin for the three months ended September 30, 2016 decreased to 72% compared to 73% for the three months ended September 30, 2015. Gross margin for the nine months ended September 30, 2016 increased to 73% compared to 72% for the nine months ended September 30, 2015. The year-over-year changes in gross margin in each period were primarily due to changes in payer and product mix.

Sales and Marketing Expenses

Sales and marketing expenses increased $2.8 million, or 45%, to $9.0 million during the three months ended September 30, 2016, compared to $6.2 million during the three months ended September 30, 2015. Sales and marketing expenses increased $6.6 million, or 38%, to $23.9 million during the nine months ended September 30, 2016, compared to $17.3 million during the nine months ended September 30, 2015. The year-over-year increases were primarily attributable to $2.0 million and $4.7 million of increased compensation and related expenses as a result of increased sales and marketing headcount in the three-month and nine-month periods ended September 30, 2016, respectively. In addition, other sales and marketing expenses increased $0.8 million and $1.3 million in the three months and nine months ended September 30, 2016, respectively; this increase was primarily due to increased field sales meetings, travel and entertainment, consulting and field sales training expenses.

Research and Development Expenses

R&D expenses increased $0.2 million, or 17%, to $1.3 million during the three months ended September 30, 2016, compared to $1.1 million during the three months ended September 30, 2015. R&D expenses increased $0.4 million, or 13%, to $3.3 million during the nine months ended September 30, 2016, compared to $2.9 million during the nine months ended September 30, 2015. The increase in R&D expenses in each of the 2016 periods was primarily attributable to increased product development and clinical study costs.

Reimbursement, General and Administrative Expenses

Reimbursement, general and administrative expenses increased $1.5 million, or 42%, to $5.1 million during the three months ended September 30, 2016, compared to $3.6 million during the three months ended September 30, 2015. Reimbursement, general and administrative expenses increased $3.0 million, or 32%, to $12.5 million during the nine months ended September 30, 2016, compared to $9.5 million during the nine months ended September 30, 2015. The increase in reimbursement, general and administrative expenses in each of the 2016 periods was primarily attributable to personnel-related expenses as a result of increased headcount in our patient services, contracting, case management, billing and collections, advocacy, reimbursement and administrative teams, as well as higher facility costs for rent, utilities, property taxes and maintenance.

Other Income, Net

Other income was $10,000 and $3,000 for the three-month periods ended September 30, 2016 and September 30, 2015, respectively. Other income was $20,000 and $18,000 for the nine-month periods ended September 30, 2016 and September 30, 2015, respectively.

Critical Accounting Policies and Estimates

A "critical accounting policy" is one which is both important to the portrayal of our financial condition and results and requires management's most subjective or complex judgments, often as a result of the need to make estimates about the effect of items that are inherently uncertain. For additional information, please see the discussion of our significant accounting policies under "Critical Accounting Policies and Significant Estimates" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Prospectus dated July 27, 2016.

Liquidity and Capital Resources

Cash Flows

At September 30, 2016, our principal sources of liquidity were cash and cash equivalents of $39.3 million and net accounts receivable of $13.0 million.

The following table summarizes our cash flows for the periods indicated:

(In thousands)	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Net cash provided by (used in):		
Operating activities	$ 4,336	$ (166)
Investing activities	(542)	(438)
Financing activities	28,440	860
Net increase in cash and cash equivalents	$ 32,234	$ 256

Net Cash Provided by (Used in) Operating Activities

Net cash provided by operating activities during the nine months ended September 30, 2016 was $4.3 million. This increase in cash provided by operations resulted from net income of $0.5 million, a $1.8 million decrease in net operating assets and liabilities, and $2.0 million of non-cash expense items. Our net operating assets and liabilities decreased $1.8 million primarily due to a decrease in accounts receivable and increases in accounts payable, accrued expenses and accrued payroll, offset by payments of product royalties and increased inventory purchases. Non-cash expense items of $2.0 million primarily consisted of stock-based compensation expense and depreciation and amortization of equipment, leasehold improvements, and patents, as well as changes in allowances for doubtful accounts.

Net cash used in operating activities during the nine months ended September 30, 2015 was $0.2 million. This use of cash was primarily due to net income of $0.1 million and $1.2 million of non-cash expense items, offset by a $1.5 million net increase in opeating assets and liabilities in the nine-month period ending September 30, 2015.

Net Cash Used in Investing Activities

Net cash used in investing activities during the nine months ended September 30, 2016 was $0.5 million, consisting primarily of purchases of product tooling and computer and manufacturing equipment. Net cash used in investing activities during the nine months ended September 30, 2015 was $0.4 million, consisting primarily of purchases of product tooling and computer and manufacturing equipment.

Net Cash Provided by Financing Activities

Until August 2016, when we closed on our initial public offering, we historically funded our operations through the issuance of capital stock. Net cash provided by financing activities during the nine months ended September 30, 2016, was $28.4 million, generated by gross proceeds of $41.2 million from the initial public offering, partially offset by $8.2 million in payments of accrued dividends on preferred stock and $4.8 million of underwriting discounts and expenses associated with the initial public offering. We also paid $1.0 million of in expenses associated with the initial public offering during the fourth quarter of 2015. Net cash provided by financing activities during the nine months ended September 30, 2015 was $0.9 million, consisting of proceeds from exercise of common stock options and warrants.

Credit Line

We have a bank credit line with borrowing availability of $2.0 million. As of September 30, 2016, we did not have any outstanding borrowings under our credit line. Our credit line bears interest based on the prime rate, which was 3.50% as of September 30, 2016. On May 11, 2016, we extended our credit agreement until May 11, 2017. Our credit line is secured by substantially all our assets, including property and equipment, accounts receivable and inventory. Our credit line contains customary conditions as to borrowing, events of default and covenants, including covenants that restrict our ability to dispose of assets, merge with or acquire other entities, and incur indebtedness or encumbrances.

Adequacy of Capital Resources

Our future capital requirements may vary significantly from those now planned and will depend on many factors, including:

- sales and marketing resources needed to further penetrate our market;
- expansion of our operations;
- response of competitors to our solutions and applications;
- costs associated with clinical research activities;
- costs to develop and implement new products, if any; and
- use of capital for acquisitions, if any.

Historically, we have experienced increases in our expenditures consistent with the growth in our operations and personnel, and we anticipate that our expenditures will continue to increase as we expand our business.

We believe our cash, cash equivalents, and cash flows from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months. We expect increased expenses in connection with meeting our obligations as a public company.

Inflation and changing prices did not have a material effect on our business during the nine months ended September 30, 2016, and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

Contractual and Commercial Commitments Summary

Our contractual obligations and commercial commitments as of September 30, 2016 are summarized below:

	Payments Due By Period				
(In thousands)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating lease obligations [(1)]	$ 3,610	$ 159	$ 2,191	$ 1,260	$ -
Future product royalties [(2)]	265	265	-	-	-
Purchase commitments [(3)]	7,566	2,755	4,811	-	-
Total	$ 11,441	$ 3,179	$ 7,002	$ 1,260	$ -

(1) We currently lease appoximiately 52,000 square feet of office and assembly space at our corporate headquarters in Minneapolis, Minnesota under a lease that expires in July 2021 and an additional 31,200 square feet of office and warehouse space at a second leased facility in Minneapolis, Minnesota under a lease that expires in October 2021.

(2) We are required to make royalty payments to a third party for our ACTitouch System through 2023. We are required to make quarterly payments through 2023, with guaranteed payments through the third quarter of 2016, and for the remaining period, equal to 6% of our quarterly revenues attributable to our ACTitouch System. In any year that these revenues exceed $40.0 million, we are required to pay 7% on revenues $40.0 million and over and 6% on revenues $40.0 million and under.

(3) Represents purchase orders issued in February 2016 to vendors for inventory expected to be received in 2016 and 2017.

Recent Accounting Pronouncements

Refer to Note 1 - "Nature of Operations and Basis of Presentation" of our condensed consolidated financial statements contained in this report for a description of recently issued accounting pronouncements that are applicable to our business.

JOBS Act

As an "emerging growth company" under the Jumpstart Our Business Startups ("JOBS") Act, we can take advantage of an extended transition period for complying with new or revised accounting standards. This allows an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to avail ourselves of this exemption and, as a result, our financial statements may not be comparable to the financial statements of issuers who are required to comply with the effective dates for new or revised accounting standards that are applicable to public 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.

We are in the process of evaluating the benefits of relying on other exemptions and reduced reporting requirements under the JOBS Act. Subject to certain conditions, as an emerging growth company, we intend to rely on certain of these exemptions, including without limitation (1) reduced financial statement reporting periods, (2) 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 of 2002 and (3) 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 earliest of: (1) the last day of the fiscal year in which we have total annual gross revenues of $1 billion or more; (2) the last day of the fiscal year following the fifth anniversary of the date of the completion of our public offering; (3) the date on which we have issued more than $1 billion in nonconvertible debt during the previous three years; or (4) the date on which we are deemed to be a large accelerated filer under the rules of the SEC.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity Risk

The principal objectives of our investment activities are to preserve principal, provide liquidity and maximize income consistent with minimizing risk of material loss. We are exposed to market risk related to changes in interest rates. However, based on the nature and current level of our investments (primarily cash and cash equivalents, which approximate fair value), we believe there is no material risk exposure. We do not enter into investments for trading or speculative purposes.

We did not have any outstanding debt as of September 30, 2016. Therefore, we do not have any material exposure to interest rate fluctuations.

Foreign Currency Risk

Our business is conducted in U.S. dollars and foreign transactions have been minimal. As we begin building relationships to commercialize our products internationally, our results of operations and cash flows may become increasingly subject to changes in foreign exchange rates.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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 September 30, 2016. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company 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 and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2016, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no material changes in our internal control over financial reporting during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

We may be from time to time subject to various claims and legal actions arising in the ordinary course of our business. There are currently no claims or legal actions, individually or in the aggregate, that would have a material adverse effect on our results of operations or financial condition.

Item 1A. Risk Factors.

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in "Risk Factors" in our Prospectus dated July 27, 2016, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors previously disclosed in that prospectus.

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

Recent Sales of Unregistered Securities

(a) *Issuances of Preferred Stock*

None.

(b) *Issuances of Common Stock*

None.

Use of Proceeds from Registered Securities

On August 2, 2016, we issued and sold 4,120,000 shares of our common stock in the initial public offering at a public offering price of $10.00 per share, for aggregate gross proceeds of $41.2 million. All of the shares issued and sold in the initial public offering were registered under the Securities Act pursuant to a Registration Statement on Form S-1 (File No. 333-209115), which was declared effective by the SEC on July 27, 2016. Piper Jaffray & Co. and William Blair & Company, L.L.C. acted as joint book-running managers for the offering. The offering terminated on August 2, 2016.

The net offering proceeds to us, after deducting underwriting discounts of approximately $2.9 million and offering expenses paid by us totaling approximately $2.9 million, were approximately $35.4 million. No offering expenses were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning 10.0% or more of any class of our equity securities or to any other affiliates. We also paid $8.2 million in cumulative accrued dividends to our Series A preferred stockholders from the issuance proceeds.

The net proceeds from our initial public offering were held in an overnight deposit account at September 30, 2016. There has been no material change in our planned uses of the net proceeds from those described in the Prospectus dated July 27, 2016.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

The exhibits filed as part of this Quarterly Report on Form 10-Q are set forth on the Exhibit Index, which Exhibit Index is incorporated herein by reference.

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.

Tactile Systems Technology, Inc.

Date: November 10, 2016

By: /s/ *Lynn L. Blake*
Lynn L. Blake
Chief Financial Officer
(Principal financial and accounting officer)

EXHIBIT INDEX

Exhibit Number	Description of Exhibit	Incorporated by Reference				Filed Herewith
		Form	File Number	Date of Filing	Exhibit Number	
3.1	Fourth Amended and Restated Certificate of Incorporation	S-1	333-209115	06/09/2016	3.1	
3.2	Amended and Restated By-laws	S-1	333-209115	05/06/2016	3.2	
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) / 15d-14(a) of the Securities Exchange Act of 1934, as amended					X
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) / 15d-14(a) of the Securities Exchange Act of 1934, as amended					X
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101.1	The following condensed consolidated financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in XBRL: (i) Balance Sheets (unaudited), (ii) Statements of Operations (unaudited), (iii) Statements of Stockholders' Equity (Deficit) (unaudited), (iv) Statements of Cash Flows (unaudited), and (v) Notes to the Condensed Consolidated Financial Statements.					X

Exhibit 31.1

CERTIFICATION PURSUANT TO RULE 13a-14(a)/l5d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Gerald R. Mattys, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Tactile Systems Technology, 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)) 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.

/s/ Gerald R. Mattys
Gerald R. Mattys
Chief Executive Officer

Date: November 10, 2016

Exhibit 31.2

**CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-
14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Lynn L. Blake, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Tactile Systems Technology, 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)) 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.

/s/ Lynn L. Blake
Lynn L. Blake
Chief Financial Officer

Date: November 10, 2016

Exhibit 32.1

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 Tactile Systems Technology, Inc. (the "Company") for the period ended September 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Gerald R. Mattys, Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

(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 results of operations of the Company.

/s/ Gerald R. Mattys
Gerald R. Mattys
Chief Executive Officer

Date: November 10, 2016

Exhibit 32.2

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 Tactile Systems Technology, Inc. (the “Company”) for the period ended September 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned, Lynn L. Blake, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to her knowledge:

(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 results of operations of the Company.

/s/ Lynn L. Blake
Lynn L. Blake
Chief Financial Officer

Date: November 10, 2016