
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2020

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)

**3701 Wayzata Blvd, Suite 300
Minneapolis, Minnesota 55416**

41-1801204
(I.R.S. Employer
Identification No.)

(Address and zip code of principal executive
offices)

(612) 355-5100

(Registrant's telephone number, including area
code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, Par Value \$0.001 Per Share	TCMD	The Nasdaq Stock 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, 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 checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>
Smaller reporting company	<input type="checkbox"/>	Emerging growth company	<input 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

19,424,679 shares of common stock, par value \$0.001 per share, were outstanding as of October 30, 2020.

TABLE OF CONTENTS

PART I—FINANCIAL INFORMATION

Item 1.	Financial Statements	5
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	38
Item 4.	Controls and Procedures	38

PART II—OTHER INFORMATION

Item 1.	Legal Proceedings	38
Item 1A.	Risk Factors	39
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	40
Item 3.	Defaults Upon Senior Securities	40
Item 4.	Mine Safety Disclosures	40
Item 5.	Other Information	40
Item 6.	Exhibits	40

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. These risks, uncertainties and other factors include, but are not limited to:

- the impacts of the COVID-19 pandemic on our business, financial condition and results of operations, and our inability to mitigate such impacts;
- the adequacy of our liquidity to pursue our business objectives;
- our ability to obtain reimbursement from third party payers for our products;
- our Chief Executive Officer transition, including disruptions and uncertainties related thereto, the potential impact on our business and future strategic direction resulting from our transition to a new Chief Executive Officer and our ability to retain other key members of senior management;
- loss or retirement of key executives;
- adverse economic conditions or intense competition;
- loss of a key supplier;
- entry of new competitors and products;
- adverse federal, state and local government regulation;
- technological obsolescence of our products;
- technical problems with our research and products;
- our ability to expand our business through strategic acquisitions;
- our ability to integrate acquisitions and related businesses;
- price increases for supplies and components;
- the effects of current and future U.S. and foreign trade policy and tariff actions; and
- the inability to carry out research, development and commercialization plans.

You should read the matters described in "Risk Factors" and the other cautionary statements made in our Annual Report on Form 10-K for the year ended December 31, 2019, in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2020, in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2020, 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 filings with the Securities and Exchange Commission (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
(Unaudited)

(In thousands, except share and per share data)	September 30, 2020	December 31, 2019
Assets		
Current assets		
Cash and cash equivalents	\$ 42,204	\$ 22,770
Marketable securities	—	22,464
Accounts receivable	36,033	33,444
Net investment in leases	9,451	8,147
Inventories	22,419	19,059
Prepaid expenses and other current assets	4,003	2,451
Total current assets	114,110	108,335
Non-current assets		
Property and equipment, net	7,177	7,408
Right of use operating lease assets	20,717	15,885
Intangible assets, net	1,671	5,312
Accounts receivable, non-current	7,100	4,184
Deferred income taxes	5,010	8,970
Other non-current assets	1,965	1,658
Total non-current assets	43,640	43,417
Total assets	\$ 157,750	\$ 151,752
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 5,053	\$ 3,843
Accrued payroll and related taxes	10,864	10,098
Accrued expenses	3,582	4,498
Income taxes payable	1,459	632
Operating lease liabilities	2,010	1,454
Other current liabilities	2,673	903
Total current liabilities	25,641	21,428
Non-current liabilities		
Accrued warranty reserve, non-current	3,071	2,541
Income taxes, non-current	—	54
Operating lease liabilities, non-current	19,919	15,134
Total non-current liabilities	22,990	17,729
Total liabilities	48,631	39,157
Commitments and Contingencies (see Note 10)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 50,000,000 shares authorized; none issued and outstanding as of September 30, 2020 and December 31, 2019	—	—
Common stock, \$0.001 par value, 300,000,000 shares authorized; 19,424,679 shares issued and outstanding as of September 30, 2020; 19,152,715 shares issued and outstanding as of December 31, 2019	19	19
Additional paid-in capital	101,157	91,874
Retained earnings	7,943	20,676
Accumulated other comprehensive income	—	26
Total stockholders' equity	109,119	112,595
Total liabilities and stockholders' equity	\$ 157,750	\$ 151,752

The accompanying notes are an integral part of these unaudited 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,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue				
Sales revenue	\$ 42,573	\$ 42,882	\$ 109,714	\$ 112,503
Rental revenue	6,519	6,730	18,173	19,926
Total revenue	49,092	49,612	127,887	132,429
Cost of revenue				
Cost of sales revenue	11,558	12,233	30,868	33,231
Cost of rental revenue	2,562	2,006	6,062	6,062
Total cost of revenue	14,120	14,239	36,930	39,293
Gross profit				
Gross profit - sales revenue	31,015	30,649	78,846	79,272
Gross profit - rental revenue	3,957	4,724	12,111	13,864
Gross profit	34,972	35,373	90,957	93,136
Operating expenses				
Sales and marketing	19,488	20,737	59,856	56,546
Research and development	1,102	1,467	3,891	3,982
Reimbursement, general and administrative	12,588	9,972	37,830	28,177
Total operating expenses	33,178	32,176	101,577	88,705
Income (loss) from operations	1,794	3,197	(10,620)	4,431
Other (expense) income	(121)	166	181	498
Income (loss) before income taxes	1,673	3,363	(10,439)	4,929
Income tax (benefit) expense	(751)	932	2,294	(1,759)
Net income (loss)	\$ 2,424	\$ 2,431	\$ (12,733)	\$ 6,688
Net income (loss) per common share				
Basic	\$ 0.12	\$ 0.13	\$ (0.66)	\$ 0.35
Diluted	\$ 0.12	\$ 0.12	\$ (0.66)	\$ 0.34
Weighted-average common shares used to compute net income (loss) per common share				
Basic	19,415,640	18,981,015	19,309,344	18,870,622
Diluted	19,747,365	19,641,853	19,309,344	19,630,721

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

Tactile Systems Technology, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Net income (loss)	\$ 2,424	\$ 2,431	\$ (12,733)	\$ 6,688
Other comprehensive (loss) income:				
Unrealized (loss) gain on marketable securities	(14)	(13)	(21)	51
Income tax related to items of other comprehensive (loss) income	(15)	4	(5)	(12)
Total other comprehensive (loss) income	(29)	(9)	(26)	39
Comprehensive income (loss)	\$ 2,395	\$ 2,422	\$ (12,759)	\$ 6,727

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

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

(In thousands, except share data)	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
	Shares	Par Value				
Balances, June 30, 2020	19,411,404	\$ 19	\$ 97,818	\$ 5,519	\$ 29	\$ 103,385
Stock-based compensation	—	—	3,164	—	—	3,164
Exercise of common stock options and vesting of restricted stock units	14,322	—	214	—	—	214
Taxes paid for net share settlement of restricted stock units	(1,047)	—	(39)	—	—	(39)
Comprehensive income (loss) for the period	—	—	—	2,424	(29)	2,395
Balances, September 30, 2020	<u>19,424,679</u>	<u>\$ 19</u>	<u>\$ 101,157</u>	<u>\$ 7,943</u>	<u>\$ —</u>	<u>\$ 109,119</u>
Balances, December 31, 2019	19,152,715	\$ 19	\$ 91,874	\$ 20,676	\$ 26	\$ 112,595
Stock-based compensation	—	—	8,288	—	—	8,288
Exercise of common stock options and vesting of restricted stock units	259,406	—	762	—	—	762
Taxes paid for net share settlement of restricted stock units	(31,095)	—	(1,592)	—	—	(1,592)
Common shares issued for employee stock purchase plan	43,653	—	1,825	—	—	1,825
Comprehensive loss for the period	—	—	—	(12,733)	(26)	(12,759)
Balances, September 30, 2020	<u>19,424,679</u>	<u>\$ 19</u>	<u>\$ 101,157</u>	<u>\$ 7,943</u>	<u>\$ —</u>	<u>\$ 109,119</u>
Balances, June 30, 2019	18,956,912	\$ 19	\$ 84,987	\$ 13,962	\$ 40	\$ 99,008
Stock-based compensation	—	—	2,330	—	—	2,330
Exercise of common stock options and vesting of restricted stock units	60,833	—	296	—	—	296
Taxes paid for net share settlement of restricted stock units	(1,713)	—	(89)	—	—	(89)
Comprehensive income (loss) for the period	—	—	—	2,431	(9)	2,422
Balances, September 30, 2019	<u>19,016,032</u>	<u>\$ 19</u>	<u>\$ 87,524</u>	<u>\$ 16,393</u>	<u>\$ 31</u>	<u>\$ 103,967</u>
Balances, December 31, 2018	18,631,125	19	79,554	9,705	(8)	89,270
Stock-based compensation	—	—	7,387	—	—	7,387
Exercise of common stock options and vesting of restricted stock units	398,477	—	1,838	—	—	1,838
Taxes paid for net share settlement of restricted stock units	(56,956)	—	(3,107)	—	—	(3,107)
Common shares issued for employee stock purchase plan	43,386	—	1,852	—	—	1,852
Comprehensive income for the period	—	—	—	6,688	39	6,727
Balances, September 30, 2019	<u>19,016,032</u>	<u>\$ 19</u>	<u>\$ 87,524</u>	<u>\$ 16,393</u>	<u>\$ 31</u>	<u>\$ 103,967</u>

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

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

(In thousands)	Nine Months Ended September 30,	
	2020	2019
Cash flows from operating activities		
Net (loss) income	\$ (12,733)	\$ 6,688
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,102	2,808
Net amortization of premiums and discounts on securities available-for-sale	(91)	(225)
Deferred income taxes	3,934	(31)
Stock-based compensation expense	8,288	7,387
Gain on other investments and maturities of marketable securities	10	—
Impairment losses	4,025	—
Changes in assets and liabilities:		
Accounts receivable	(2,589)	(3,349)
Net investment in leases	(1,304)	(7,628)
Inventories	(3,538)	(5,693)
Income taxes	773	(2,051)
Prepaid expenses and other assets	(1,553)	(418)
Right of use operating lease assets	509	107
Medicare accounts receivable, non-current	(2,916)	(1,141)
Accounts payable	938	979
Accrued payroll and related taxes	766	3,915
Accrued expenses and other liabilities	1,134	1,073
Net cash (used in) provided by operating activities	(2,245)	2,421
Cash flows from investing activities		
Proceeds from maturities of securities available-for-sale	22,500	16,000
Purchases of securities available-for-sale	—	(14,859)
Purchases of property and equipment	(1,623)	(4,276)
Intangible assets costs	(163)	(154)
Other investments	(30)	—
Net cash provided by (used in) investing activities	20,684	(3,289)
Cash flows from financing activities		
Taxes paid for net share settlement of restricted stock units	(1,592)	(3,107)
Proceeds from exercise of common stock options	762	1,838
Proceeds from the issuance of common stock from the employee stock purchase plan	1,825	1,852
Net cash provided by financing activities	995	583
Net increase (decrease) in cash and cash equivalents	19,434	(285)
Cash and cash equivalents – beginning of period	22,770	20,099
Cash and cash equivalents – end of period	\$ 42,204	\$ 19,814
Supplemental cash flow disclosure		
Cash paid for taxes	\$ 475	\$ 326
Capital expenditures incurred but not yet paid	\$ 41	\$ 801

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

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

Note 1. Nature of Business and Operations

Tactile Systems Technology, Inc. (“we,” “us,” and “our”) is the sole manufacturer and distributor of the Flexitouch® and Entre™ systems, medical devices that help control symptoms of lymphedema, a chronic and progressive medical condition. Our products are purchased or rented for at-home use and are recommended by vascular, wound and lymphedema clinics throughout the United States.

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, resulting in our reincorporation as a Delaware corporation. The resulting corporation assumed the name Tactile Systems Technology, Inc. In September 2013, we began doing business as “Tactile Medical”.

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. As a result, at August 2, 2016, we did not have any redeemable convertible preferred stock issued or outstanding.

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 yet met their annual out-of-pocket payment obligations, we experience substantially reduced demand for our products. We typically experience higher revenue in the third and fourth quarters of the year when patients have met their annual insurance deductibles, thereby reducing their out-of-pocket costs for our products, and because patients desire to exhaust their flexible spending accounts at year end. This seasonality applies only to purchases and rentals of our products by patients covered by commercial insurance and is not relevant to Medicare, Medicaid or the Veterans Administration, as those payers either do not have plans that have declining deductibles over the course of the plan year and/or do not have plans that include patient deductibles for purchases or rentals of our products. Further, seasonality trends in 2020 may be significantly different than in prior years as a result of the COVID-19 pandemic and related impacts.

Note 2. Basis of Presentation

The 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, 2020, are not necessarily indicative of results to be expected for the year ending December 31, 2020, or for any other interim period or for any future year. The condensed consolidated interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2019.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of Tactile Systems Technology, Inc. and its wholly owned subsidiary, Swelling Solutions, Inc. All intercompany balances and transactions have been eliminated in consolidation.

Risks and Uncertainties

Coronavirus (COVID-19)

The United States economy in general and our business specifically have been negatively affected by the COVID-19 pandemic. We have seen adverse impacts as it relates to the decline in the number of patients that healthcare facilities and clinics are able to treat due to enhanced safety protocols. There are no reliable estimates of how long the pandemic will last or how many people are likely to be affected by it. For that reason, we are unable to reasonably estimate the long-term impact of the pandemic on our business at this time. Our first priority with regard to the COVID-19 pandemic is to ensure the safety and health of our employees, clinicians and patients. Subject to that, we are focusing our efforts on attempting to continue our business operations in this unprecedented environment. Part of our strategy includes changing many of our processes and practices in an effort to help mitigate the impact of COVID-19 on our business so that we can support our clinicians and safely make our at-home therapies available to patients. Since the onset of COVID-19, we have remained proactive to ensure we continue to adapt to our employees, clinicians and patients needs. These changes to our business include, but are not limited to:

- Initially, we modified our operations with the primary focus on keeping our employees safe while continuing to serve our clinicians and patients. As an essential business under federal guidelines, we continued to manufacture product and implemented multiple, smaller rotational shifts and other best practices to help protect the health and safety of our workforce. More recently, we have migrated closer to our pre-COVID work shifts, however we have implemented more stringent safety measures including mandatory use of face masks, social distancing and temperature checks for our employees.
- We have continued to incorporate remote and flexible work arrangements for employees whenever possible, including real-time, online training of our new sales representatives.
- Continuing employee travel and contact restrictions to reduce exposure.
- Collaborating with payers to modify coverage requirements by serving patients virtually.
- In concert with COVID-19 social distancing requirements and recommendations, we moved to a “no contact” virtual patient training model. This new model substantially reduced the need for in-person contact and visits to patients’ homes and clinics in order to protect the health and limit the exposure of both our trainers and patients. Accordingly in the second quarter of 2020, we inactivated our independent healthcare practitioners, who acted as at-home trainers to educate patients on the proper use of our systems, in order to allow these individuals to have access to specific COVID related financial relief.
- We continue to transition large, in-person medical education programs in favor of conducting virtual meetings whenever possible.
- When in-person visits are required, we are supporting clinicians and patients by using rigorous infection control practices.

We cannot assure you that these changes to our processes and practices will be successful in mitigating the impact of COVID-19 on our business. We continue to evaluate and, if appropriate, will adopt other measures in the future related to the ongoing safety of our employees, clinicians and patients.

Use of Estimates

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

Comprehensive Income (Loss)

Comprehensive income (loss) reflects the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Our comprehensive income (loss) represents net income (loss) adjusted for unrealized gains and losses on available-for-sale marketable securities and the related taxes.

Note 3. Summary of Significant Accounting Policies

Significant Accounting Policies

There were no material changes in our significant accounting policies during the nine months ended September 30, 2020, except as set forth below. See Note 3 – “Summary of Significant Accounting Policies” to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2019, for information regarding our significant accounting policies.

Impairment of Long-Lived Assets

We review long-lived assets, including property and equipment and patents, for impairment whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be fully recoverable. We assess long-lived assets used in operations for impairment indicators, including when undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

In the second quarter of 2020, we reevaluated the Airwear wrap go-to market plan, and determined to focus our strategy on more advanced solutions within our core, long-standing Flexitouch and Entre franchises. Accordingly, we made the strategic decision to discontinue the Airwear wrap in the second quarter of 2020. Due to the planned discontinuation of the product line, we recorded a \$4.0 million non-cash impairment charge to fully write-off the inventory and long-lived assets of the Airwear wrap in the quarter ended June 30, 2020. The majority of the impairment charge was comprised of the intangible assets and property and equipment, totaling \$3.6 million, and was classified within the reimbursement, general and administrative line of the Condensed Consolidated Statements of Operations. The inventory-related component of the impairment charge was \$0.4 million, and was classified within the cost of revenue line of the Condensed Consolidated Statements of Operations.

Recently Adopted Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-13, “Financial Instruments — Credit Losses” (“ASU 2016-13”), which introduced a new model for recognizing credit losses on financial instruments based on an estimate of the current expected credit losses. The new current expected credit losses (“CECL”) model generally calls for the immediate recognition of all expected credit losses and applies to financial instruments and other assets, including accounts receivable and other financial assets measured at amortized cost, debt securities and other financial assets. This guidance replaces the previous incurred loss model for measuring expected credit losses and requires expected losses on available-for-sale debt securities to be recognized through an allowance for credit losses rather than as reductions in the amortized cost of the securities. We adopted ASU 2016-13 as of January 1, 2020, and it did not have an impact on the condensed consolidated financial statements.

Accounting Pronouncements Issued Not Yet Adopted

In December 2019, the FASB issued ASU No. 2019-12, “Income Taxes (Topic 740) — Simplifying the Accounting for Income Taxes” (“ASU 2019-12”), which is intended to simplify various aspects of the accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. We are currently evaluating the applicability and impact of the standard on our condensed consolidated financial statements and related disclosures.

Note 4. Marketable Securities

There were no investments in marketable securities at September 30, 2020. At December 31, 2019 investments in marketable securities were classified as available-for-sale and consisted of the following:

(In thousands)	At December 31, 2019			
	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	\$ 19,950	\$ 14	\$ 1	\$ 19,963
Corporate debt securities	2,493	8	—	2,501
Marketable securities	<u>\$ 22,443</u>	<u>\$ 22</u>	<u>\$ 1</u>	<u>\$ 22,464</u>

There were no net pre-tax unrealized gains for marketable securities at September 30, 2020. There were no sales of marketable securities during the nine months ended September 30, 2020.

There were no marketable securities in an unrealized loss position at September 30, 2020.

At December 31, 2019, unrealized losses and the fair value of marketable securities aggregated by investment category and the length of time the securities were in a continuous loss position, were as follows:

(In thousands)	At December 31, 2019					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government and agency obligations	\$ 5,997	\$ 1	\$ —	\$ —	\$ 5,997	\$ 1
Corporate debt securities	—	—	—	—	—	—
Marketable securities	<u>\$ 5,997</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,997</u>	<u>\$ 1</u>

Note 5. Inventories

Inventories consisted of the following:

(In thousands)	At September 30, 2020	At December 31, 2019
Finished goods	\$ 9,287	\$ 6,508
Component parts and work-in-process	13,132	12,551
Total inventories	<u>\$ 22,419</u>	<u>\$ 19,059</u>

Note 6. Intangible Assets

Our patents and other intangible assets are summarized as follows:

(In thousands)	Weighted-Average Amortization Period	At September 30, 2020		
		Gross Carrying Amount	Accumulated Amortization	Net Amount
Patents	12 years	\$ 388	\$ 55	\$ 333
Defensive intangible assets	4 years	1,125	378	747
Customer accounts	3 years	125	57	68
Total amortizable intangible assets		1,638	490	1,148
Patents pending		523	—	523
Total intangible assets		<u>\$ 2,161</u>	<u>\$ 490</u>	<u>\$ 1,671</u>

(In thousands)	Weighted-Average Amortization Period	At December 31, 2019		
		Gross Carrying Amount	Accumulated Amortization	Net Amount
Patents	11 years	\$ 4,386	\$ 447	\$ 3,939
Defensive intangible assets	5 years	1,125	250	875
Customer accounts	3 years	125	37	88
Total amortizable intangible assets		5,636	734	4,902
Patents pending		410	—	410
Total intangible assets		<u>\$ 6,046</u>	<u>\$ 734</u>	<u>\$ 5,312</u>

Amortization expense was \$0.1 million for each of the three months ended September 30, 2020 and 2019, and \$0.3 million and \$0.4 million for the nine months ended September 30, 2020 and 2019, respectively. Future amortization expenses are expected as follows:

(In thousands)	
2020 (October 1 - December 31)	\$ 58
2021	230
2022	230
2023	200
2024	179
Thereafter	251
Total	<u>\$ 1,148</u>

Note 7. Accrued Expenses

Accrued expenses consisted of the following:

(In thousands)	At September 30, 2020		At December 31, 2019	
Warranty	\$	1,443	\$	1,218
Legal and consulting		675		617
Travel and business		413		776
In-transit inventory		129		106
Sales and use tax		183		200
Clinical studies		38		85
Lease termination costs		—		1,200
Other		701		296
Total	\$	3,582	\$	4,498

Note 8. Warranty Reserves

The activity in the warranty reserve during and as of the end of the reporting periods presented was as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Beginning balance	\$ 4,208	\$ 3,002	\$ 3,759	\$ 2,566
Warranty provision	820	664	2,097	1,677
Processed warranty claims	(514)	(386)	(1,342)	(963)
Ending balance	<u>\$ 4,514</u>	<u>\$ 3,280</u>	<u>\$ 4,514</u>	<u>\$ 3,280</u>
Accrued warranty reserve, current	\$ 1,443	\$ 1,053	\$ 1,443	\$ 1,053
Accrued warranty reserve, non-current	<u>3,071</u>	<u>2,227</u>	<u>3,071</u>	<u>2,227</u>
Total accrued warranty reserve	<u>\$ 4,514</u>	<u>\$ 3,280</u>	<u>\$ 4,514</u>	<u>\$ 3,280</u>

Note 9. Credit Agreement

On August 3, 2018, we entered into a credit agreement with Wells Fargo Bank, National Association, which was amended by a First Amendment dated February 12, 2019, a Waiver and Second Amendment dated March 25, 2019, and a Third Amendment dated August 2, 2019 (collectively, the "Credit Agreement"), which expires on August 3, 2021.

The Credit Agreement provides for a \$10.0 million revolving credit facility. Subject to satisfaction of certain conditions, we may increase the amount of the revolving loans available under the Credit Agreement and/or add one or more term loan facilities in an amount not to exceed an incremental \$25.0 million in the aggregate, such that the total aggregate principal amount of loans available under the Credit Agreement (including under the revolving credit facility) does not exceed \$35.0 million. As of September 30, 2020, and the date on which we filed this report, we did not have any outstanding borrowings under the Credit Agreement.

Our obligations under the Credit Agreement are secured by a security interest in substantially all of our and our subsidiaries' assets and are also guaranteed by our subsidiaries. The Credit Agreement contains a number of restrictions and covenants, including that we maintain compliance with a maximum leverage ratio and a minimum liquidity covenant. As of September 30, 2020, we were in compliance with all financial covenants under the Credit Agreement.

Note 10. Commitments and Contingencies

Lease Obligations

We lease property and equipment under operating leases, typically with terms greater than 12 months, and determine if an arrangement contains a lease at inception. In general, an arrangement contains a lease if there is an identified asset and we have the right to direct the use of and obtain substantially all of the economic benefit from the use of the identified asset. We record an operating lease liability at the present value of lease payments over the lease term on the commencement date. The related right of use ("ROU") operating lease asset reflects rental escalation clauses, as well as renewal options and/or termination options. The exercise of lease renewal and/or termination options are at our discretion and are included in the determination of the lease term and lease payment obligations when it is deemed reasonably certain that the option will be exercised. When available, we use the rate implicit in the lease to discount lease payments to present value; however, certain leases do not provide a readily determinable implicit rate. Therefore, we must estimate our incremental borrowing rate to discount the lease payments based on information available at lease commencement.

We classify our leases as buildings, vehicles or computer and office equipment and do not separate lease and nonlease components of contracts for any of the aforementioned classifications. In accordance with applicable guidance, we do not record leases with terms that are less than one year on the Condensed Consolidated Balance Sheet.

None of our lease agreements contain material restrictive covenants or residual value guarantees.

Buildings

We lease certain office and warehouse space at various locations in the United States where we provide services. These leases are typically greater than one year with fixed, escalating rents over the noncancelable terms and, therefore, ROU operating lease assets and operating lease liabilities are recorded on the Condensed Consolidated Balance Sheet, with rent expense to be recognized on a straight-line basis over the term of the lease. The remaining lease terms vary from approximately three to ten years as of September 30, 2020.

In March 2008, we entered into a noncancelable operating lease agreement for building space for our previous corporate headquarters that provided for monthly rent, real estate taxes and operating expenses that was subsequently extended to July 31, 2021. Due to the move to our new headquarters in September 2019, we entered into a termination agreement for our former corporate headquarters on December 31, 2019. We agreed to pay \$1.2 million in order to terminate all future rights and obligations of the lease. The lease was removed from our ROU operating lease assets and operating lease liabilities and the total net loss on termination of \$1.1 million was recorded in the reimbursement, general and administrative line of our Condensed Consolidated Statements of Operations.

We entered into a lease ("initial lease") in October 2018, for approximately 80,000 square feet of office space for our new corporate headquarters in Minneapolis, Minnesota. In December 2018, we amended the initial lease to add approximately 29,000 square feet of additional office space, which is accounted for as a separate lease ("second lease") in accordance with ASU No. 2016-02, "Leases" (Topic 842) ("ASC 842"). In December 2019, we further amended the lease which extended the expiration date of the initial lease, extended the expiration date of and added approximately 4,000 square feet to the second lease, as well as added approximately 37,000 square feet of additional office space, accounted for as a separate lease ("third lease") in accordance with ASC 842. The portion of the space under the initial lease was placed in service in September 2019. This portion was recognized as an operating lease and included in the ROU operating lease assets and operating lease liabilities on the Condensed Consolidated Balance Sheets beginning as of September 30, 2019. The portion of the space covered under the second lease commenced on September 1, 2020. This portion was recognized as an operating lease and included in the ROU operating lease assets and operating lease liabilities on the Condensed Consolidated Balance Sheets as of September 30, 2020. The portion of the space covered under the third lease is expected to be occupied and commence in the second half of 2021.

Vehicles

We lease vehicles for certain members of our field sales organization under a vehicle fleet program whereby the initial, noncancelable lease is for a term of 367 days, thus more than one year. Subsequent to the initial term, the lease becomes a month-to-month, cancelable lease. As of September 30, 2020, we had approximately 69 vehicles with agreements within the initial, noncancelable lease term that are recorded as ROU operating lease assets and operating lease liabilities. In addition to monthly rental fees specific to the vehicle, there are fixed monthly nonlease components that have been included in the ROU operating lease assets and operating lease liabilities. The nonlease components are not significant.

Computer and Office Equipment

We also have operating lease agreements for certain computer and office equipment. The remaining lease terms as of September 30, 2020, ranged from less than one year to approximately three years with fixed monthly payments that are included in the ROU operating lease assets and operating lease liabilities. The leases provide an option to purchase the related equipment at fair market value at the end of the lease. The leases will automatically renew as a month-to-month rental at the end of the lease if the equipment is not purchased or returned.

Lease Position, Undiscounted Cash Flow and Supplemental Information

The table below presents information related to our ROU operating lease assets and operating lease liabilities that we have recorded:

(In thousands)	At September 30, 2020	At December 31, 2019
Right of use operating lease assets	\$ 20,717	\$ 15,885
Operating lease liabilities:		
Current	\$ 2,010	\$ 1,454
Non-current	19,919	15,134
Total	\$ 21,929	\$ 16,588
Operating leases:		
Weighted average remaining lease term	9.6 years	10.1 years
Weighted average discount rate	4.3%	4.6%
	Nine Months Ended September 30,	
	2020	2019
Supplemental cash flow information for our operating leases:		
Cash paid for operating lease liabilities	\$ 1,849	\$ 1,147
Non-cash right of use assets obtained in exchange for new operating lease obligations	\$ 6,664	\$ 16,296

The table below reconciles the undiscounted cash flows under the operating lease liabilities recorded on the Condensed Consolidated Balance Sheet for the periods presented:

(In thousands)	
2020 (October 1 - December 31)	\$ 788
2021	2,781
2022	2,643
2023	2,594
2024	2,575
Thereafter	15,344
Total minimum lease payments	26,725
Less: Amount of lease payments representing interest	(4,796)
Present value of future minimum lease payments	21,929
Less: Current obligations under operating lease liabilities	(2,010)
Non-current obligations under operating lease liabilities	\$ 19,919

As of September 30, 2020, we have additional lease commitments of \$7.1 million related to amendments to existing building leases that have not yet commenced. As the lessee we are involved in providing guidance to the lessor for related improvements, however these improvements are managed and owned by the lessor.

Operating lease costs were \$0.8 million and \$0.6 million for the three months ended September 30, 2020 and 2019, respectively. Operating lease costs were \$2.1 million and \$1.3 for the nine months ended September 30, 2020 and 2019, respectively.

Major Vendors

We had purchases from two major vendors that accounted for 31% and 33% of our total purchases for the three and nine months ended September 30, 2020, respectively. We had purchases from two major vendors that accounted for 42% and 37% of our total purchases for the three and nine months ended September 30, 2019, respectively.

Purchase Commitments

We issued purchase orders prior to September 30, 2020, totaling \$20.5 million for goods that we expect to receive within the next year.

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. Discretionary contributions to the 401(k) plan totaled \$0.1 million for each of the three ended September 30, 2020 and 2019, and \$0.2 million for each of the nine months ended September 30, 2020 and 2019.

Note 11. Stockholders' Equity

Stock-Based Compensation

Our 2016 Equity Incentive Plan (the "2016 Plan") authorizes us to grant stock options, stock appreciation rights, restricted stock, stock units and other stock-based awards to employees, non-employee directors and certain consultants and advisors. There were up to 4,800,000 shares of our common stock initially reserved for issuance pursuant to the 2016 Plan. The 2016 Plan provides that the number of shares reserved and available for issuance under the 2016 Plan will automatically increase annually on January 1 of each calendar year, commencing in 2017 and ending on and including January 1, 2026, by an amount equal to the lesser of: (a) 5% of the number of common shares of stock outstanding as of December 31 of the immediately preceding calendar year, or (b) 2,500,000 shares; provided, however, that our Board of Directors may

determine that any annual increase be a lesser number. In addition, all awards granted under our 2007 Omnibus Stock Plan and our 2003 Stock Option Plan that were outstanding when the 2016 Plan became effective and that are forfeited, expired, cancelled, settled for cash or otherwise not issued, will become available for issuance under the 2016 Plan. Pursuant to the automatic increase feature of the 2016 Plan, shares were added as approved by the Board of Directors for each year since inception other than 2019, at which point, the Board exercised its prerogative to forgo the increase. On January 1, 2020, 952,697 shares were added as available for issuance thereunder. As of September 30, 2020, 4,658,176 shares were available for future grant pursuant to the 2016 Plan.

Upon adoption and approval of the 2016 Plan, all of our previous equity incentive compensation plans were terminated. However, existing awards under those plans continue to vest in accordance with the original vesting schedules and will expire at the end of their original terms.

In the second fiscal quarter of 2020, our Board of Directors appointed a new President and Chief Executive Officer (“CEO”), effective June 8, 2020. In conjunction with the acceptance of the written offer, our CEO received both restricted stock units and stock option awards under our 2016 Plan during the third fiscal quarter of 2020 and the stock options have a seven year term. A portion of the awards will vest on June 30, 2021, with the remaining portion of the awards vesting over a period of three years from the date of grant. Further, all of the stock options included in these awards require that our stock price exceed \$40.15 for 20 consecutive trading days during the term of the option in order to vest.

We recorded stock-based compensation expense of \$3.2 million and \$2.3 million for the three months ended September 30, 2020 and 2019, respectively, and \$8.3 million and \$7.4 million for the nine months ended September 30, 2020 and 2019, respectively. This expense was allocated as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Cost of revenue	\$ 171	\$ 75	\$ 358	\$ 249
Sales and marketing expenses	1,436	1,029	3,915	3,262
Research and development expenses	87	95	269	275
Reimbursement, general and administrative expenses	1,470	1,131	3,746	3,601
Total stock-based compensation expense	<u>\$ 3,164</u>	<u>\$ 2,330</u>	<u>\$ 8,288</u>	<u>\$ 7,387</u>

Stock Options

We have granted stock options to certain participants that vest over three or four years and typically have a contractual term of seven or ten years. Stock-based compensation expense included in the Condensed Consolidated Statements of Operations for stock options was \$1.1 million and \$0.6 million for the three months ended September 30, 2020 and 2019, respectively, and \$3.0 million and \$2.0 million for the nine months ended September 30, 2020 and 2019, respectively.

At September 30, 2020, there was approximately \$7.9 million of total unrecognized pre-tax 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 2.1 years.

Our stock option activity for the nine months ended September 30, 2020, was as follows:

(In thousands except options and per share data)	Options Outstanding	Weighted- Average Exercise Price Per Share ⁽¹⁾	Weighted- Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽²⁾
Balance at December 31, 2019	866,955	\$ 28.76	6.1 years	\$ 33,957
Granted	284,674	\$ 47.66		
Exercised	(132,911)	\$ 5.74		\$ 6,224
Forfeited	(33,818)	\$ 53.54		
Expired	(2,718)	\$ 63.02		
Balance at September 30, 2020	<u>982,182</u>	\$ 36.41	5.8 years	\$ 8,829
Options exercisable at September 30, 2020	461,138	\$ 23.35	4.9 years	\$ 8,102

(1) The exercise price of each option granted during the period shown was equal to the market price of the underlying stock on the date of grant.

(2) The aggregate intrinsic value of options exercised represents the difference between the exercise price of the option and the closing stock price of our common stock on the date of exercise. The aggregate intrinsic value of options outstanding represents the difference between the exercise price of the option and the closing stock price of our common stock on the last trading day of the period.

Options exercisable of 539,487 as of September 30, 2019, had a weighted-average exercise price of \$5.15 per share.

Time-Based Restricted Stock Units

We have granted time-based restricted stock units to certain participants under the 2016 Plan that are stock-settled with common shares. Time-based restricted stock units granted under the 2016 Plan vest over one to three years. Stock-based compensation expense included in the Condensed Consolidated Statements of Operations for time-based restricted stock units was \$1.4 million and \$1.0 million for the three months ended September 30, 2020 and 2019, respectively, and \$4.0 million and \$2.9 million for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, there was approximately \$7.5 million of total unrecognized pre-tax compensation expense related to outstanding time-based restricted stock units that is expected to be recognized over a weighted-average period of 1.9 years.

Our time-based restricted stock unit activity for the nine months ended September 30, 2020, was as follows:

(In thousands except unit and per unit data)	Units Outstanding	Weighted- Average Grant Date Fair Value Per Unit	Aggregate Intrinsic Value ⁽¹⁾
Balance at December 31, 2019	171,687	\$ 43.74	\$ 11,591
Granted	149,175	\$ 48.20	
Modification	2,288	\$ 21.85	
Vested	(94,640)	\$ 38.07	
Forfeited	(11,701)	\$ 55.33	
Balance at September 30, 2020	<u>216,809</u>	\$ 48.42	\$ 7,933
Deferred and unissued at September 30, 2020 ⁽²⁾	6,967	\$ 40.27	\$ 255

(1) The aggregate intrinsic value of restricted stock units outstanding was based on our closing stock price on the last trading day of the period.

(2) For the nine months ended September 30, 2020, there were 858 restricted stock units granted to non-employee directors in lieu of their quarterly cash retainer payments. These restricted stock units were fully vested upon grant and represent the right to receive one share of common stock, per unit, upon the earlier of the director's termination of service as a director of ours or the occurrence of a change of control of us. These restricted stock units are included in the "Granted" line in the table above and are also included in the "Vested" line in the table above due to their being fully vested upon grant. As of September 30, 2020, there were 6,967 outstanding restricted stock units that have been previously granted to non-employee directors in lieu of their quarterly director retainer payments.

Performance-Based Restricted Stock Units

We have granted performance-based restricted stock units ("PSUs") to certain participants under the 2016 Plan. These PSUs have both performance-based and time-based vesting features. The PSUs granted in 2018 were earned to the extent performance goals based on revenue and adjusted EBITDA were achieved in 2019. The PSUs granted in 2019 will be earned if and to the extent performance goals based on revenue and adjusted EBITDA are achieved in 2020. The PSUs granted in 2020 will be earned if and to the extent performance goals based on revenue and adjusted EBITDA are achieved in 2021. The number of PSUs earned will depend on the level at which the performance targets are achieved and can range from 50% of target if the minimum performance threshold is achieved and up to 150% of target if maximum performance is achieved. One-third of the earned PSUs will vest on the date the Compensation and Organization Committee certifies the number of PSUs earned, and the remaining two-thirds of the earned PSUs will vest on the first anniversary of that certification date. All earned and vested PSUs will be settled in shares of common stock.

Stock-based compensation expense recognized for PSUs was \$0.4 million and \$0.5 million for the three months ended September 30, 2020 and 2019, respectively, and \$0.5 million and \$1.7 million for the nine months ended September 30, 2020 and 2019, respectively. The stock-based compensation expense for the nine months ended September 30, 2020 reflects a \$1.0 million benefit due to a change in the estimated payout associated with PSUs granted in 2019 being below the minimum performance target threshold level, as defined. As of September 30, 2020, there was approximately \$1.4 million of total unrecognized pre-tax compensation expense related to outstanding PSUs that is expected to be recognized over a weighted average period of 2.0 years.

Our performance-based restricted stock unit activity for the nine months ended September 30, 2020, was as follows:

<i>(In thousands except unit and per unit data)</i>	Performance- Based Units Outstanding	Weighted- Average Grant Date Fair Value Per Unit	Aggregate Intrinsic Value ⁽¹⁾
Balance at December 31, 2019	91,151	\$ 44.63	\$ 6,154
Granted	31,731	\$ 50.41	
Vested	(21,589)	\$ 33.62	
Forfeited	(8,846)	\$ 70.46	
Balance at September 30, 2020	<u>92,447</u>	\$ 46.72	\$ 3,383

(1) The aggregate intrinsic value of performance-based restricted stock units outstanding was based on our closing stock price on the last trading day of the period.

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 ESPP 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 ESPP provides for six-month purchase periods, beginning on May 16 and November 16 of each calendar year.

A total of 1,600,000 shares of common stock was initially reserved for issuance under the ESPP. This share reserve will automatically be supplemented each January 1, commencing in 2017 and ending on and including January 1, 2026, by an amount equal to the least of (a) 1% of the shares of our common stock outstanding on the immediately preceding December 31, (b) 500,000 shares or (c) such lesser amount as our Board of Directors may determine. Pursuant to the automatic increase feature of the ESPP, shares were added as approved by the Board of Directors for each year since inception other than 2019, at which point, the Board exercised its prerogative to forgo the increase. On January 1, 2020, 190,539 shares were added as available for issuance thereunder. As of September 30, 2020, 1,618,335 shares were available for future issuance under the ESPP. We recognized stock-based compensation expense associated with the ESPP of \$0.3 million and \$0.2 million for the three months ended September 30, 2020 and 2019, respectively, and \$0.8 million and \$0.7 million for the nine months ended September 30, 2020 and 2019, respectively.

Note 12. Revenue

We derive our revenue from the sale and rental of our compression products to our customers in the United States. The following table presents our revenue, inclusive of sales and rental revenue, disaggregated by product categories:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue				
Flexitouch system	\$ 42,908	\$ 44,699	\$ 112,621	\$ 119,767
Other products ⁽¹⁾	6,184	4,913	15,266	12,662
Total	<u>\$ 49,092</u>	<u>\$ 49,612</u>	<u>\$ 127,887</u>	<u>\$ 132,429</u>
Percentage of total revenue				
Flexitouch system	87 %	90 %	88 %	90 %
Other products ⁽¹⁾	13 %	10 %	12 %	10 %
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

(1) The "other products" line primarily includes revenue from our Entre system. The Actitouch system and the Airwear wrap contributed immaterial amounts of revenue for each of the three and nine months ended September 30, 2020 and 2019.

Rental revenue for the three and nine months ended September 30, 2020 and 2019, was primarily from private insurers. Our revenue from third-party payers, inclusive of sales and rental revenue, for the three and nine months ended September 30, 2020 and 2019, are summarized in the following table:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Private insurers and other payers	\$ 34,554	\$ 35,909	\$ 90,459	\$ 93,932
Veterans Administration	6,788	7,764	18,168	23,690
Medicare	7,750	5,939	19,260	14,807
Total	<u>\$ 49,092</u>	<u>\$ 49,612</u>	<u>\$ 127,887</u>	<u>\$ 132,429</u>

Our rental revenue is derived from rent-to-purchase arrangements that typically range from three to ten months. Under ASC 840 (the previous guidance for lease accounting), our rental revenue was recognized as month-to-month, cancelable leases; however, because title transfers to the patient, with whom we have the contract, upon the termination of the lease term and because collectability is probable, under ASC 842, these are recognized as sales-type leases. Each rental agreement contains two components, the controller and related garments, both of which are interdependent and recognized as one lease component.

Rental agreements initiated subsequent to January 1, 2019, are recorded as sales-type leases in accordance with ASC 842, whereby rental revenue and cost of rental revenue are recognized upon the lease commencement date. In 2019, in accordance with applicable guidance, we continued to recognize rental agreements commencing prior to December 31, 2018, on a month-to-month basis as an operating lease until they were completed. These rental agreements do not have an impact on the revenue results in 2020. Total rental revenue for the three and nine months ended September 30, 2019 included both operating and sales-type lease revenue. Operating lease revenue was \$0.6 million and \$4.8 million for the three and nine months ended September 30, 2019.

The revenue and associated cost of revenue of sales-type leases are recognized on the lease commencement date and a net investment in leases is recorded on the Condensed Consolidated Balance Sheet. We bill the patients' insurance payers monthly over the duration of the rental term. We record the net investment in leases and recognize revenue upon commencement of the lease in the amount of the expected consideration to be received through the monthly payments. Similar to our sales revenue, the transaction price is impacted by multiple factors, including the terms and conditions contracted by third party payers. As the rental contract resides with the patients, we have elected the portfolio approach, at the payer level, to determine

the expected consideration, which considers the impact of early terminations. While the contract is with the patient, in certain circumstances, the third party payer elects an initial rental period with an option to extend. We assess the likelihood of extending the lease at the onset of the lease to determine if the option is reasonably certain to be exercised. As the lease is short-term in nature, we anticipate collection of substantially all of the net investment within the first year of the lease agreement. Completion of these payments represents the fair market value of the equipment, and as such, interest income is not applicable.

Sales-type lease revenue and the associated cost of revenue for the three and nine months ended September 30, 2020 and 2019, was:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Sales-type lease revenue	\$ 6,519	\$ 6,088	\$ 18,173	\$ 15,088
Cost of sales-type lease revenue	2,562	1,932	6,062	5,358
Gross profit	<u>\$ 3,957</u>	<u>\$ 4,156</u>	<u>\$ 12,111</u>	<u>\$ 9,730</u>

Note 13. 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 adjusting 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 reporting purposes, including for depreciation and amortization, warranty and vacation accruals, and deductions related to allowances for doubtful accounts receivable and inventory reserves. Our provision for income taxes included current federal and state income tax expense, as well as deferred federal and state income tax expense.

The effective tax rate for the three months ended September 30, 2020 was a benefit of 55%, compared to an expense of 27% for the three months ended September 30, 2019. The primary driver of the change in our effective tax rate is attributable to a change in projected taxable income, including proportionately higher tax benefits for stock-based compensation as compared to the same period last year. We recorded an income tax benefit of \$0.8 million and an expense of \$0.9 million for the three months ended September 30, 2020 and 2019, respectively.

The effective tax rate for the nine months ended September 30, 2020 was an expense of 17%, compared to a benefit of 36% for the nine months ended September 30, 2019. The primary driver of the change in our effective tax rate is attributable to a change in projected taxable income, including proportionately lower tax benefits for stock-based compensation as compared to the same period last year. We recorded an income tax expense of \$2.3 million and a benefit of \$1.8 million for the nine months ended September 30, 2020 and 2019, respectively.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority is more-likely-than-not to 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.

We are not currently under examination in any 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 14. Net Income Per Share

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

(In thousands, except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Net income (loss)	\$ 2,424	\$ 2,431	\$ (12,733)	\$ 6,688
Weighted-average shares outstanding	19,415,640	18,981,015	19,309,344	18,870,622
Dilutive effect of stock-based awards	331,725	660,838	—	760,099
Weighted-average shares used to compute diluted net (loss) income per share	19,747,365	19,641,853	19,309,344	19,630,721
Net income (loss) per share - Basic	\$ 0.12	\$ 0.13	\$ (0.66)	\$ 0.35
Net income (loss) per share - Diluted	\$ 0.12	\$ 0.12	\$ (0.66)	\$ 0.34

The following common stock equivalents were excluded from the computation of diluted net (loss) income per share for the periods presented because including them would have been anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Restricted stock units	104,786	37,813	223,776	39,905
Common stock options	594,117	198,663	982,182	202,179
Performance stock units	38,666	25,724	113,646	25,724
Employee stock purchase plan	60,196	—	48,360	—
Total	797,765	262,200	1,367,964	267,808

Note 15. Fair Value Measurements

We determine the fair value of our assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. We use a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last unobservable, to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1). The next highest priority is based on quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in non-active markets or other observable inputs (Level 2). The lowest priority is given to unobservable inputs (Level 3).

The following provides information regarding fair value measurements for our cash equivalents and marketable securities as of September 30, 2020, and December 31, 2019, according to the three-level fair value hierarchy:

At September 30, 2020				
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Recurring Fair Value Measurements:				
Money market mutual funds	\$ 9,159	\$ —	\$ —	\$ 9,159
U.S. government and agency obligations	5,000	—	—	5,000
Total	\$ 14,159	\$ —	\$ —	\$ 14,159

At December 31, 2019				
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Recurring Fair Value Measurements:				
Money market mutual funds	\$ 481	\$ —	\$ —	\$ 481
U.S. government and agency obligations	25,954	—	—	25,954
Corporate debt securities	—	2,501	—	2,501
Total	\$ 26,435	\$ 2,501	\$ —	\$ 28,936

During the three and nine months ended September 30, 2020, there were no transfers within the three-level hierarchy. A significant transfer is recognized when the inputs used to value a security have been changed, which merits a transfer between the disclosed levels of the valuation hierarchy.

The fair values for our money market mutual funds, U.S. government and agency obligations and corporate debt securities are determined based on valuations provided by external investment managers who obtain them from a variety of industry standard data providers.

The carrying amounts of financial instruments such as cash equivalents, accounts receivable, other assets, accounts payable, accrued expenses and other liabilities approximate their related fair values due to the short-term maturities of these items. Non-financial assets, such as equipment and leasehold improvements, and intangible assets are subject to non-recurring fair value measurements if they are deemed impaired. As of June 30, 2020, we re-measured the value of our intangible assets related to the Airwear wrap product line to their fair value, which was deemed to be \$0.

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 the condensed consolidated financial statements and the accompanying notes thereto included elsewhere in this report.

Coronavirus (COVID-19)

The United States economy in general and our business specifically have been negatively affected by the COVID-19 pandemic. There are no reliable estimates of how long the pandemic will last or how many people are likely to be affected by it. For that reason, we are unable to reasonably estimate the long-term impact of the pandemic on our business at this time. Our first priority with regard to the COVID-19 pandemic is to ensure the safety and health of our employees, clinicians and patients. Subject to that, we are focusing our efforts on attempting to continue our business operations in this unprecedented environment. Part of our strategy includes changing many of our processes and practices in an effort to help mitigate the impact of COVID-19 on our business so that we can support our clinicians and safely make our at-home therapies available to patients. Since the onset of COVID-19, we have remained proactive to ensure we continue to adapt to our employees, clinicians and patients needs. These changes to our business include, but are not limited to:

- Initially, we modified our operations with the primary focus on keeping our employees safe while continuing to serve our clinicians and patients. As an essential business under federal guidelines, we continued to manufacture product and implemented multiple, smaller rotational shifts and other best practices to help protect the health and safety of our workforce. More recently, we have migrated closer to our pre-COVID work shifts, however we have implemented more stringent safety measures including mandatory use of face masks, social distancing and temperature checks for our employees.
- We have continued to incorporate remote and flexible work arrangements for employees whenever possible, including real-time, online training of our new sales representatives.
- Continuing employee travel and contact restrictions to reduce exposure.
- Collaborating with payers to modify coverage requirements by serving patients virtually.
- In concert with COVID-19 social distancing requirements and recommendations, we moved to a "no contact" virtual patient training model. This new model substantially reduced the need for in-person contact and visits to patients' homes and clinics in order to protect the health and limit the exposure of both our trainers and patients. Accordingly in the second quarter of 2020, we inactivated our independent healthcare practitioners, who acted as at-home trainers to educate patients on the proper use of our systems, in order to allow these individuals to have access to specific COVID related financial relief.
- We continue to transition large, in-person medical education programs in favor of conducting virtual meetings whenever possible.
- When in-person visits are required, we are supporting clinicians and patients by using rigorous infection control practices.

We cannot assure you that these changes to our processes and practices will be successful in mitigating the impact of COVID-19 on our business. We continue to evaluate and, if appropriate, will adopt other measures in the future related to the ongoing safety of our employees, clinicians and patients. Additional information related to the COVID-19 pandemic is included in the MD&A sections below.

Overview

We are a medical technology company that develops and provides innovative medical devices for the treatment of chronic diseases. Our mission is to help people suffering from chronic diseases live better and care for themselves at home. We focus our efforts 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. 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. 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 insurance payers as a key for controlling rising healthcare costs. Our solutions deliver cost-effective, clinically proven, long-term treatment for people with these chronic diseases.

Our current products are the Flexitouch system and Entre 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. In September 2016, we received 510(k) clearance from the FDA for the Flexitouch system in treating lymphedema of the head and neck. In June 2017, we announced that we received 510(k) clearance from the FDA for the Flexitouch Plus, the third-generation version of our Flexitouch system. We derive the vast majority of our revenue from our Flexitouch system. Sales and rentals of our Flexitouch system represented 88% and 90% of our revenue in the nine months ended September 30, 2020 and 2019, respectively.

We introduced our Entre system in the United States in February 2013. The Entre system is sold or rented to patients who need a simple pump 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, 2020 and 2019, sales and rentals of our Entre system represented 12% and 10% of our revenue, respectively.

In October 2018, we licensed, from Sun Scientific, Inc., the intellectual property rights related to the Airwear Gradient Compression Wrap, or the Airwear wrap, in the United States and Canada, for use in all medical applications, including but not limited to swelling/edema and ulcers (including lymphedema and chronic venous insufficiency conditions), but excluding the use of the intellectual property in the field of prophylaxis for deep vein thrombosis. In the second quarter of 2020, we reevaluated the Airwear wrap go-to market plan, and determined to focus our strategy on more advanced solutions within our core, long-standing Flexitouch and Entre franchises. Accordingly, we made the strategic decision to discontinue the Airwear wrap in the second quarter of 2020. Due to the planned discontinuation of the product line, we recorded a \$4.0 million non-cash impairment charge to fully write-off the inventory and long-lived assets of the Airwear wrap in the quarter ended June 30, 2020. See Note 3 - “Summary of Significant Accounting Policies” to the consolidated financial statements in this report for more information regarding this impairment charge and discontinuation. Further, effective July 31, 2020, Sun Scientific, Inc. terminated the license agreement with us related to the Airwear wrap.

To support the growth of our business, we invest heavily in our commercial infrastructure, consisting of our direct sales force, home training materials, contracted at-home trainers, reimbursement capabilities and clinical expertise. We market our products in the United States using a direct-to-patient and -provider model. Our direct salesforce has grown to a team of over 250 employees as of September 30, 2020, compared to over 230 employees as of September 30, 2019. 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.

In concert with COVID-19 social distancing requirements, we moved to a “no contact” virtual patient training model. This new model substantially reduced the need for in-person contact and visits to patients’ homes and clinics. Accordingly, in the second quarter of 2020, we inactivated our independent healthcare practitioners, who acted as at-home trainers to educate patients on the proper use of our systems.

As it relates to the impact of COVID-19 on our third quarter commercial processes, we continued to see a certain number of healthcare facilities and clinics with restricted access to their clinicians, reduced patient

consultations and treatments, or being closed temporarily due to the pandemic. We continued to see some of the restrictions loosen, in line with the applicable governmental regulations. As most of our clinician customers practice outside of a hospital, we can interact with clinicians and patients on a virtual basis, using video conferencing and other non-direct means. We expect these virtual interactions with clinicians and patients to continue into the future until the pandemic subsides, and perhaps as a best practice in the future. To that end, we will continue to work towards expanding our commercial organization throughout the fourth quarter of 2020 by adding to our direct sales force.

We invest substantial resources in our Reimbursement Department to improve operational efficiencies and enhance individual payer expertise, while continuing our strategic focus of payer development. Our Payer Development group is composed of both strategic and analytical teams, with focus on payer decision-maker relationships and education, payer policy development and revision, payer contract negotiations, and payer data analysis. Our experienced Reimbursement Operations group is responsible for verifying patient insurance benefits, individual patient case development, prior authorization submissions, case follow-up, and appeals when necessary. Since the onset of COVID-19, our Reimbursement Department has been actively working with Medicare and a broad base of private payers to understand the ever-changing reimbursement criteria that are being introduced. We have seen increased flexibility in coverage criteria with select payers in which they now allow the use of virtual patient interactions in place of the previously required in-person interactions. However, as these circumstances are ever-changing, the extent to which these changes will remain in place and the impact on our business in the future are not determinable at this time.

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 the development of clinical evidence in support of our products. Most clinical studies require observation and interaction with clinicians and patients to monitor results and progress. Given the impact of COVID-19, patient recruitment for our clinical studies involving our products and clinical outcomes has been suspended. We do not have an expectation for when the clinical studies will resume.

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.

To date, our supply chain has not been materially impacted by COVID-19. We continue to receive our product on time and believe that we have enough safety stock to meet our short and mid-term demand. However, we cannot assure you that our supply chain will not be materially impacted in the future.

For the three months ended September 30, 2020, we generated revenue of \$49.1 million and had net income of \$2.4 million, compared to revenue of \$49.6 million and net income of \$2.4 million for the three months ended September 30, 2019. For the nine months ended September 30, 2020, we generated revenue of \$127.9 million and had a net loss of \$12.7 million, compared to revenue of \$132.4 million and net income of \$6.7 million for the nine months ended September 30, 2019. Our primary sources of capital to date have been from operating income, private placements of our capital stock and capital raised in 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, 2020 and 2019

The following tables present our results of operations for the periods indicated:

(In thousands)	Three Months Ended September 30,				Change	
	2020		2019		\$	%
Condensed Consolidated Statement of Operations Data:		% of revenue		% of revenue		
Revenue						
Sales revenue	\$ 42,573	87 %	\$ 42,882	86 %	\$ (309)	(1)%
Rental revenue	6,519	13 %	6,730	14 %	(211)	(3)%
Total revenue	49,092	100 %	49,612	100 %	(520)	(1)%
Cost of revenue						
Cost of sales revenue	11,558	24 %	12,233	25 %	(675)	(6)%
Cost of rental revenue	2,562	5 %	2,006	4 %	556	28 %
Total cost of revenue	14,120	29 %	14,239	29 %	(119)	(1)%
Gross profit						
Gross profit - sales revenue	31,015	63 %	30,649	61 %	366	1 %
Gross profit - rental revenue	3,957	8 %	4,724	10 %	(767)	(16)%
Gross profit	34,972	71 %	35,373	71 %	(401)	(1)%
Operating expenses						
Sales and marketing	19,488	40 %	20,737	42 %	(1,249)	(6)%
Research and development	1,102	2 %	1,467	3 %	(365)	(25)%
Reimbursement, general and administrative	12,588	26 %	9,966	20 %	2,622	26 %
Total operating expenses	33,178	68 %	32,170	65 %	1,008	3 %
Income from operations	1,794	3 %	3,203	6 %	(1,409)	(44)%
Other (expense) income	(121)	— %	160	— %	(281)	(176)%
Income before income taxes	1,673	3 %	3,363	6 %	(1,690)	(50)%
Income tax (benefit) expense	(751)	(2)%	932	2 %	(1,683)	(181)%
Net income	\$ 2,424	5 %	\$ 2,431	4 %	\$ (7)	(0)%

(In thousands)	Nine Months Ended September 30,				Change	
	2020		2019		\$	%
Condensed Consolidated Statement of Operations Data:		% of		% of		
		revenue		revenue		
Revenue						
Sales revenue	\$ 109,714	86 %	\$ 112,503	85 %	\$ (2,789)	(2)%
Rental revenue	18,173	14 %	19,926	15 %	(1,753)	(9)%
Total revenue	127,887	100 %	132,429	100 %	(4,542)	(3)%
Cost of revenue						
Cost of sales revenue	30,868	24 %	33,231	25 %	(2,363)	(7)%
Cost of rental revenue	6,062	5 %	6,062	5 %	—	— %
Total cost of revenue	36,930	29 %	39,293	30 %	(2,363)	(6)%
Gross profit						
Gross profit - sales revenue	78,846	62 %	79,272	60 %	(426)	(1)%
Gross profit - rental revenue	12,111	9 %	13,864	10 %	(1,753)	(13)%
Gross profit	90,957	71 %	93,136	70 %	(2,179)	(2)%
Operating expenses						
Sales and marketing	59,856	47 %	56,546	43 %	3,310	6 %
Research and development	3,891	3 %	3,982	3 %	(91)	(2)%
Reimbursement, general and administrative	37,830	30 %	28,159	21 %	9,671	34 %
Total operating expenses	101,577	80 %	88,687	67 %	12,890	15 %
(Loss) income from operations	(10,620)	(9)%	4,449	3 %	(15,069)	N.M. %
Other income	181	— %	480	— %	(299)	(62)%
(Loss) income before income taxes	(10,439)	(9)%	4,929	3 %	(15,368)	N.M. %
Income tax expense (benefit)	2,294	2 %	(1,759)	(1)%	4,053	N.M. %
Net (loss) income	\$ (12,733)	(10)%	\$ 6,688	4 %	\$ (19,421)	N.M. %

"N.M." Not Meaningful

Revenue

Revenue decreased \$0.5 million, or 1%, to \$49.1 million in the three months ended September 30, 2020, compared to \$49.6 million in the three months ended September 30, 2019. The decrease in total revenue was attributable to a decrease of \$1.8 million, or 4%, in sales and rentals of the Flexitouch system, offset partially by an increase of \$1.3 million, or 26%, in sales and rentals of the Entre system in the quarter ended September 30, 2020. The decrease in third quarter revenue continued to be negatively impacted by COVID-19, primarily from social distancing requirements and safety protocols imposed within clinics. The decrease in third quarter revenue was partially offset by the continued expansion of our commercial team, effective virtual educational events and an increase in the number of Medicare patients served.

Revenue decreased \$4.5 million, or 3%, to \$127.9 million in the nine months ended September 30, 2020, compared to \$132.4 million in the nine months ended September 30, 2019, which decrease was primarily attributable to a decrease of approximately \$7.1 million, or 6%, in sales and rentals of our Flexitouch system, offset partially by an increase of \$2.6 million, or 21%, in sales and rentals of the Entre system for the nine months ended September 30, 2020. Revenue in the first two months of 2020 was ahead of our expectations. Beginning in March 2020 and continuing through the third quarter, revenue was impacted by the COVID-19 pandemic, which limited our ability to access our clinician customers and their patients. Specifically, we saw healthcare facilities and clinics restricting access to their clinicians, reducing patient consultations, or closing temporarily due to COVID-19.

Revenue from the Veterans Administration represented 14% and 16% of total revenue in the three months ended September 30, 2020 and 2019, respectively. Revenue from the Veterans Administration represented 14% and 18% of total revenue in the nine months ended September 30, 2020 and 2019, respectively. Revenue from Medicare represented 16% and 12% of total revenue in the three months ended September 30, 2020 and 2019, respectively. Revenue from Medicare represented 15% and 11% of total revenue in the nine months ended September 30, 2020 and 2019, respectively.

The following tables summarize our revenue by product for the three and nine months ended September 30, 2020 and 2019, both in dollars and percentage of total revenue:

(In thousands)	Three Months Ended September 30,		Change	
	2020	2019	\$	%
Revenue				
Flexitouch system	\$ 42,908	\$ 44,699	\$ (1,791)	(4)%
Other products ⁽¹⁾	6,184	4,913	1,271	26%
Total	<u>\$ 49,092</u>	<u>\$ 49,612</u>	<u>\$ (520)</u>	(1)%
Percentage of total revenue				
Flexitouch system	87%	90%		
Other products ⁽¹⁾	13%	10%		
Total	<u>100%</u>	<u>100%</u>		

(1) The "other products" line primarily includes revenue from our Entre system. The Actitouch system and the Airwear wrap contributed immaterial amounts of revenue for each of the three months ended September 30, 2020 and 2019.

(In thousands)	Nine Months Ended September 30,		Change	
	2020	2019	\$	%
Revenue				
Flexitouch system	\$ 112,621	\$ 119,767	\$ (7,146)	(6)%
Other products ⁽¹⁾	15,266	12,662	2,604	21%
Total	\$ 127,887	\$ 132,429	\$ (4,542)	(3)%
Percentage of total revenues				
Flexitouch system	88%	90%		
Other products ⁽¹⁾	12%	10%		
Total	100%	100%		

(1) The "other products" line primarily includes revenue from our Entre system. The Actitouch system and the Airwear wrap contributed immaterial amounts of revenue for each of the nine months ended September 30, 2020 and 2019.

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 yet met their annual out-of-pocket payment obligations, we experience substantially reduced demand for our products. We typically experience higher revenue in the third and fourth quarters of the year when patients have met their annual insurance deductibles, thereby reducing their out-of-pocket costs for our products, and because patients desire to exhaust their flexible spending accounts at year end. This seasonality applies only to purchases and rentals of our products by patients covered by commercial insurance and is not relevant to Medicare, Medicaid or the Veterans Administration, as those payers either do not have plans that have declining deductibles over the course of the plan year and/or do not have plans that include patient deductibles for purchases or rentals of our products. Further, seasonality trends in 2020 may be significantly different than in prior years as a result of the COVID-19 pandemic and related impacts.

Cost of Revenue and Gross Margin

Cost of revenue decreased \$0.1 million, or 1%, to \$14.1 million in the three months ended September 30, 2020, compared to \$14.2 million in the three months ended September 30, 2019. Cost of revenue decreased \$2.4 million, or 6%, to \$36.9 million in the nine months ended September 30, 2020, compared to \$39.3 million in the nine months ended September 30, 2019. The decrease in cost of revenue in both periods was primarily attributable to a decrease in the number of Flexitouch systems sold and rented, slightly offset by an increase in other products sales and rentals, and in the nine month period, the \$0.4 million inventory impairment charge related to discontinuing the Airwear wrap product line.

The total gross margin rate was 71% of sales in each of the three and nine months ended September 30, 2020, compared to 71% and 70% in the three and nine months ended September 30, 2019, respectively. The increase for the nine month period was primarily attributable to the composition of sales and rental mix by payer.

Sales and Marketing Expenses

Sales and marketing expenses decreased \$1.2 million, or 6%, to \$19.5 million in the three months ended September 30, 2020, compared to \$20.7 million in the three months ended September 30, 2019. The decrease was primarily attributable to a \$1.6 million reduction of our external patient training expense as a result of pivoting to more virtual patient trainings, \$1.1 million decrease from reduced tradeshows and professional services, and \$0.7 million of reduced travel and entertainment expense due to decreased travel activities, partially offset by continued investment in our field sales team and marketing initiatives to increase clinician awareness, resulting in an increase of \$2.2 million in personnel-related compensation expense, including \$0.4 million of incremental stock-based compensation expense.

Sales and marketing expenses increased \$3.3 million, or 6%, to \$59.9 million in the nine months ended September 30, 2020, compared to \$56.6 million in the nine months ended September 30, 2019. The increase was primarily attributable to our continued investment in our field sales team and marketing initiatives to increase clinician awareness, resulting in an increase of \$8.3 million in personnel-related compensation

expense, including \$0.7 million of incremental stock-based compensation expense, partially offset by a reduction of \$2.9 million in our external patient training expense as a result of moving to increased virtual patient trainings, \$1.5 million in reduced travel and entertainment expense due to decreased travel activities and a \$0.6 million decrease from reduced tradeshows and professional services.

Research and Development Expenses

Research and development (“R&D”) expenses decreased \$0.4 million, or 25%, to \$1.1 million in the three months ended September 30, 2020, compared to \$1.5 million in the three months ended September 30, 2019, which decrease was primarily attributable to slowing of clinical studies activities as a result of COVID-19.

R&D expenses decreased \$0.1 million, or 2%, to \$3.9 million in the nine months ended September 30, 2020, compared to \$4.0 million in the nine months ended September 30, 2019, which decrease was primarily attributable to the slowing of clinical studies activities as a result of COVID-19, partially offset by first quarter investments in our R&D team and clinical studies projects.

Reimbursement, General and Administrative Expenses

Reimbursement, general and administrative expenses increased \$2.6 million, or 26%, to \$12.6 million in the three months ended September 30, 2020, compared to \$10.0 million in the three months ended September 30, 2019. This increase was primarily attributable to a \$1.6 million increase in personnel-related compensation expense as a result of increased headcount in our reimbursement operations, payer development and corporate functions, including \$0.4 million severance related expense related to the departure of our Chief Operating Officer. The increase in reimbursement, general and administrative expenses was also attributable to a \$1.0 million increase in occupancy costs, depreciation expense, legal and professional fees.

Reimbursement, general and administrative expenses increased \$9.7 million, or 34%, to \$37.8 million in the nine months ended September 30, 2020, compared to \$28.2 million in the nine months ended September 30, 2019. This increase was primarily attributable to a \$3.6 million impairment charge related to the write-off of our Airwear wrap-related long-lived assets and a \$3.3 million increase in occupancy costs, depreciation expense, legal and professional fees. The increase in reimbursement, general and administrative expenses was also attributable to a \$2.8 million increase in personnel-related compensation expense as a result of increased headcount in our reimbursement operations, payer development and corporate functions, including \$0.4 million severance related expense related to the departure of our Chief Operating Officer.

Other Income (Expense), Net

Other income (expense), net was an expense of \$0.1 million and income of \$0.2 million for the three months ended September 30, 2020 and 2019, respectively, and was income of \$0.2 million and \$0.5 million for the nine months ended September 30, 2020 and 2019, respectively. Other income (expense) was primarily impacted by interest income realized on marketable securities and the gain and loss on cost method investments.

Income Taxes

We recorded an income tax benefit of \$0.8 million and an income tax expense of \$0.9 million for the three months ended September 30, 2020 and 2019, respectively. The primary driver of this change was an increase in tax-deductible share-based compensation activity, as compared to the prior year period. We recorded an income tax expense of \$2.3 million and an income tax benefit of \$1.8 million for the nine months ended September 30, 2020 and 2019, respectively. The primary driver of this change was a decrease in tax-deductible share-based compensation activity, as compared to the prior year period.

Liquidity and Capital Resources

Cash Flows

At September 30, 2020, our principal sources of liquidity were cash and cash equivalents of \$42.2 million and net accounts receivable of \$36.0 million, as well as the borrowing capacity available under our Credit Agreement.

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

(In thousands)	Nine Months Ended September 30,	
	2020	2019
Net cash (used in) provided by:		
Operating activities	\$ (2,245)	\$ 2,421
Investing activities	20,684	(3,289)
Financing activities	995	583
Net increase (decrease) in cash and cash equivalents	\$ 19,434	\$ (285)

Operating Activities

Net cash used in operating activities during the nine months ended September 30, 2020, was \$2.2 million, resulting from a net loss of \$12.7 million and a net increase in operating assets and liabilities of \$7.9 million, which were offset by non-cash net income adjustments of \$18.2 million. The non-cash net income adjustments consisted primarily of \$8.3 million of stock-based compensation expense, a \$4.0 million impairment loss charge related to the write-off of our Airwear wrap product line, a \$3.9 million decrease in deferred taxes and \$2.1 million of depreciation and amortization expense. The uses of cash related to changes in operating assets primarily consisted of increases in accounts receivable of \$5.5 million, in inventories of \$3.5 million, in prepaid expenses and other assets of \$1.6 million and in net investment in leases of \$1.3 million, partially offset by a decrease in income taxes receivable of \$0.7 million. The changes in operating liabilities consisted primarily of increases in accrued expenses and other liabilities of \$1.1 million, in accounts payable of \$0.9 million and accrued payroll and related taxes of \$0.8 million.

Net cash provided by operating activities during the nine months ended September 30, 2019, was \$2.4 million, resulting from net income of \$6.7 million and non-cash net income adjustments of \$9.9 million, which were offset by a net increase in operating assets and liabilities of \$14.2 million. The non-cash net income adjustments consisted primarily of \$7.4 million of stock-based compensation expense and \$2.6 million of depreciation and amortization expense. The uses of cash related to changes in operating assets primarily consisted of increases in net investment in leases of \$7.6 million, in inventory of \$5.7 million, in accounts receivable of \$4.5 million, and in income taxes receivable of \$2.1 million. The changes in operating liabilities consisted of increases in accrued payroll and related taxes of \$3.9 million, in accrued expenses and other liabilities of \$1.1 million and in accounts payable of \$1.0 million.

Investing Activities

Net cash provided by investing activities during the nine months ended September 30, 2020, was \$20.7 million, primarily consisting of \$22.5 million in proceeds from maturities of marketable securities, partially offset by \$1.8 million in purchases of property and equipment and patent costs.

Net cash used in investing activities during the nine months ended September 30, 2019, was \$3.3 million, primarily consisting of \$4.3 million in purchases of property and equipment partially offset by \$1.1 million in net marketable securities activity.

Financing Activities

Net cash provided by financing activities during the nine months ended September 30, 2020, was \$1.0 million, consisting of \$2.6 million in proceeds from exercise of common stock options and the issuance of common stock under the ESPP, partially offset by \$1.6 million in taxes paid for the net share settlement of restricted stock units.

Net cash provided by financing activities during the nine months ended September 30, 2019, was \$0.6 million, consisting of proceeds from the issuance of common stock under the ESPP of \$1.9 million and exercises of common stock options of \$1.8 million, partially offset by \$3.1 million in taxes paid for the net share settlement of restricted stock units.

Credit Agreement

On August 3, 2018, we entered into a credit agreement with Wells Fargo Bank, National Association, which was amended by a First Amendment dated February 12, 2019, a Waiver and Second Amendment dated March 25, 2019, and a Third Amendment dated August 2, 2019 (collectively, the "Credit Agreement"), which expires on August 3, 2021.

The Credit Agreement provides for a \$10.0 million revolving credit facility, with the ability to increase the amount of the revolving loans available and/or add one or more term loan facilities not to exceed an incremental \$25.0 million, subject to satisfaction of certain conditions. As of September 30, 2020, and the date on which we filed this report, we did not have any outstanding borrowings under the Credit Agreement.

Our obligations under the Credit Agreement are secured by a security interest in substantially all of our and our subsidiaries' assets and are also guaranteed by our subsidiaries. The Credit Agreement contains a number of restrictions and covenants, including that we maintain compliance with a maximum leverage ratio and a minimum liquidity covenant. As of September 30, 2020, we were in compliance with all financial covenants under the Credit Agreement. For additional information on the Credit Agreement, see Note 9 – "Credit Agreement" to the condensed consolidated financial statements in this report.

Adequacy of Capital Resources

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

- the impact of the COVID-19 pandemic on our business;
- sales and marketing resources needed to further penetrate our market;
- expansion of our operations domestically and/or internationally;
- response of competitors to our solutions and applications;
- costs associated with clinical research activities;
- costs to develop and implement new products; and
- use of capital for acquisitions or licenses, if any.

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

Although the impact of the COVID-19 pandemic is difficult to predict, we believe our cash, cash equivalents and cash flows from operations together with the Credit Agreement will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

Inflation and changing prices did not have a material effect on our business during the nine months ended September 30, 2020, and we do not expect that inflation or changing prices will materially affect our business for at least the next twelve months.

In August 2017, we filed a shelf registration statement on Form S-3 with the SEC. Under the shelf registration statement, we may offer and sell from time to time up to \$200.0 million of common stock, preferred stock, debt securities, warrants, rights or units. The shelf registration statement also registered for resale from time to time up to 5,703,534 shares of our common stock held by the selling stockholders named therein. In September 2017, certain of the selling stockholders completed a secondary offering of 3,795,000 shares of our common stock at a public offering price of \$33.00 per share. We did not receive any proceeds from the sale of the shares by the selling stockholders.

Coronavirus Aid, Relief, and Economic Security (CARES) Act

On March 27, 2020 the CARES Act was signed into law. The CARES Act is a tax-and-spending package intended to provide economic relief to address the impact of the COVID-19 pandemic. The CARES Act includes several tax provisions that, among other things, allow businesses to carry back net operating losses (“NOLs”) arising in 2018, 2019, and 2020 to the prior five tax years. In the third quarter, we collected \$2.9 million related to the carry back of our NOLs arising from these prior tax years.

In addition, the CARES Act provided \$100 billion in relief funds to hospitals and other healthcare providers on the front lines of the COVID-19 pandemic. An initial \$30 billion of the funds were released for immediate infusion and were distributed to all facilities and providers that received Medicare fee-for-service (“FFS”) reimbursements in 2019. On April 10, 2020, we received \$1.2 million of the initial allotment to all facilities and providers which was determined to be our proportionate share. Within 45 days of each reporting period end, we are required to comply with reporting requirements confirming funds were utilized in a manner described within the terms and conditions outlined by the U.S. Department of Health & Human Services. We are currently in the process of evaluating the impact and applicability of these funds on our financial statements.

Contractual and Commercial Commitments Summary

For a discussion on our contractual and commercial commitments, see Item 7, “Contractual and Commercial Commitments Summary,” included in our Annual Report on Form 10-K for the year ended December 31, 2019. There have been no material changes since December 31, 2019.

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.

Recent Accounting Pronouncements

Refer to Note 3 – “Summary of Significant Accounting Policies” of the condensed consolidated financial statements contained in this report for a description of recently issued accounting pronouncements that are applicable to our business.

Critical Accounting Policies and Estimates

A “critical accounting policy” is one that 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 Annual Report on Form 10-K for the year ended December 31, 2019.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For a discussion on our market risks, see Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” included in our Annual Report on Form 10-K for the year ended December 31, 2019. There have been no material changes since December 31, 2019.

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, 2020. 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, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that occurred during the quarter ended September 30, 2020, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, we are subject to various claims and legal proceedings arising in the ordinary course of business. Regardless of outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

On February 13, 2019, we were served with a sealed amended complaint venued in the United States District Court in the Southern District of Texas, Houston Division, captioned *United States ex rel Veterans First Medical Supply, LLC vs. Tactile Medical Systems Technology, Inc.*, Case No. 18-2871, which had been filed on January 23, 2019. The complaint is a *qui tam* action on behalf of the United States brought by one of our competitors. The United States has declined to intervene in this action. The complaint alleges that we violated the Federal Anti-Kickback Statute claiming that we submitted false claims and made false statements in connection with the Medicare and Medicaid programs, and that we engaged in unlawful retaliation in violation of the Federal False Claims Act. The complaint seeks damages, statutory penalties, attorneys’ fees, treble damages and costs. We filed a motion to dismiss on April 5, 2019. This motion was denied on February 21, 2020. On March 6, 2020, we filed our answer to the complaint and asserted counterclaims. On May 7, 2020, the plaintiff filed a motion to dismiss our counterclaims. On September 8, 2020, we filed a Motion for Partial Summary Judgement. Both motions are currently pending decision. We believe that the plaintiff’s allegations are without merit and we intend to continue to vigorously defend against the lawsuit.

On September 29, 2020, a complaint in a purported securities class action lawsuit was filed against us and three of our present or former officers in the United States District Court for the District of Minnesota under the following caption: *Brian Mart, Individually and on Behalf of All Others Similarly Situated v. Tactile Systems Technology, Inc., et al.* The complaint alleges, among other things, that the defendants made materially false and misleading statements regarding our business, operational and compliance policies, and financial results during the time period from May 7, 2018 through June 8, 2020 (“alleged class period”), in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Rule 10b-5 promulgated thereunder. Plaintiff seeks to represent a class consisting of all investors who purchased our stock during the alleged class period. The complaint seeks damages in an unspecified amount and an award of costs and expenses, including attorneys’ and experts’ fees. We have not yet responded to the complaint, and do not have a deadline to respond, but we intend to move to dismiss it.

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 Annual Report on Form 10-K for the year ended December 31, 2019, which could materially affect our business, financial condition or future results. There have been no material changes in our risk factors from those disclosed in that report, except as set forth below.

The potential effects of the COVID-19 pandemic are likely to impact, and may exacerbate or trigger, many of our risk factors that were included in the “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2019. In addition, the following risk factor is added:

The COVID -19 pandemic has adversely affected, and we expect that it will continue to adversely affect, our business, financial condition and results of operations.

The COVID-19 pandemic, and efforts taken to address the pandemic, have negatively impacted the global economy and our business, and are expected to continue to have negative effects. The pandemic has caused us to modify many of our business practices, but we cannot assure you that those modifications will be successful in mitigating the negative impacts of COVID-19. As described elsewhere in this report, as a result of the COVID-19 pandemic, a number of healthcare facilities and clinics have restricted access to their clinicians, reduced patient consultations and treatments, or closed temporarily due to the pandemic. We have seen adverse impacts as it relates to the decline in the number of patients that healthcare facilities and clinics are able to treat due to enhanced safety protocols. Further, due to the impact of COVID-19, patient recruitment for our clinical studies involving our products and clinical outcomes has been suspended.

Further, the extent to which the COVID-19 pandemic will impact our business, financial condition and results of operations in the future will depend on future developments, which are highly uncertain and cannot be predicted, including, but not limited to, the duration, spread, severity, and impact of the COVID-19 pandemic, the effects of the COVID-19 pandemic on our clinician customers and their patients, our suppliers and our payers, and the remedial actions and stimulus measures adopted by governmental authorities, and to what extent normal economic and operating conditions can resume. Even after the COVID-19 pandemic has subsided, we may continue to experience adverse impacts to our business as a result of any economic recession or depression that has occurred or may occur in the future.

The potential negative impacts of the COVID-19 pandemic on us include, but are not limited to:

- further reduced demand for our products;
- reductions in coverage or reimbursement of our products by payers;
- our inability to effectively conduct virtual patient demonstrations and trainings;
- continued restricted access to clinicians, further reduced patient consultations and treatments, and additional or further closures of healthcare facilities and clinics;
- disruptions to our supply chain;

- limitations on the ability of our workforce to perform their duties effectively;
- disruptions in the timely delivery of our products to patients;
- increased risks of phishing and other cybersecurity attacks;
- delayed reviews and approvals by the U.S. Food and Drug Administration;
- increased unemployment rates in the U.S., which may lead to a reduced number of patients with available insurance coverage, resulting in a reduction in the demand for our products;
- significant stock market volatility, resulting in extreme price and volume fluctuations;
- our inability to focus on or expend resources toward the expansion of our business; and
- continued adverse impact on liquidity or sources of capital.

Given the evolving health, economic, social and governmental impacts of the COVID-19 pandemic, the potential impact that the COVID-19 pandemic could have on us remains uncertain, but it could have a material adverse effect on our business, financial condition and results of operations.

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.

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 below.

EXHIBIT INDEX

Exhibit Number	Description of Exhibit	Incorporated by Reference			Filed Herewith
		Form	Date of Filing	Exhibit Number	
3.1	Amended and Restated Certificate of Incorporation, as amended through May 9, 2019	8-K	05/09/2019	3.2	
3.2	Amended and Restated By-laws, effective May 9, 2019	8-K	05/09/2019	3.3	
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 financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2020, formatted in Inline XBRL: (i) Balance Sheets, (ii) Statements of Operations, (iii) Statements of Comprehensive Income (Loss), (iv) Statements of Stockholders' Equity, (v) Statements of Cash Flows, and (vi) Notes to the Condensed Consolidated Financial Statements				X
104.1	Cover page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101.1)				X

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 2, 2020

By: /s/ Brent A. Moen
Brent A. Moen
Chief Financial Officer
(Principal financial and accounting officer)

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, Daniel L. Reuvers, 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 internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. 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
 - d. 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/ Daniel L. Reuvers

Daniel L. Reuvers
Chief Executive Officer

Date: November 2, 2020

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, Brent A. Moen, 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 internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. 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
 - d. 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/ Brent A. Moen

Brent A. Moen

Chief Financial Officer

Date: November 2, 2020

**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, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Daniel L. Reuvers, 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/ Daniel L. Reuvers

Daniel L. Reuvers
Chief Executive Officer

Date: November 2, 2020

**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, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Brent A. Moen, Chief Financial 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/ Brent A. Moen

Brent A. Moen
Chief Financial Officer

Date: November 2, 2020
