Anika Therapeutics, Inc.
Form 10-Q
July 28, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

o **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 000-21326

Anika Therapeutics, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Massachusetts	**04-3145961**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

32 Wiggins Avenue, Bedford, Massachusetts	**01730**
(Address of Principal Executive Offices)	(Zip Code)

(781) 457-9000

(Registrant's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

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

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. o

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes o No o

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of July 20, 2017 there were 14,658,440 outstanding shares of Common Stock, par value $.01 per share.

ANIKA THERAPEUTICS, INC.

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References in this Quarterly Report on Form 10-Q to “we,” “us,” “our,” “our company,” and other similar references refer to Anika Therapeutics, Inc. and its subsidiaries unless the context otherwise indicates.

ANIKA, ANIKA THERAPEUTICS, CINGAL, HYAFF, MONOVISC, and ORTHOVISC are our registered trademarks. This Quarterly Report on Form 10-Q also contains registered marks, trademarks, and trade names that are the property of other companies and licensed to us.

PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Anika Therapeutics, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share data and per share data)

(unaudited)

ASSETS	June 30, 2017	December 31, 2016
Current assets:		
Cash and cash equivalents	117,874	104,261
Investments	25,000	20,500
Accounts receivable, net of reserves of $210 and $194 at June 30, 2017 and December 31, 2016, respectively	30,450	27,598
Inventories, net	17,584	15,983
Prepaid expenses and other current assets	1,973	2,098
Total current assets	192,881	170,440
Property and equipment, net	52,272	52,296
Long-term deposits and other	1,389	69
Intangible assets, net	10,626	10,227
Goodwill	7,836	7,214
Total assets	$265,004	$ 240,246
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$5,465	$ 2,303
Accrued expenses and other current liabilities	5,673	6,496
Income taxes payable	2,303	-
Total current liabilities	13,441	8,799
Other long-term liabilities	422	2,126
Deferred tax liability	7,003	6,548
Commitments and contingencies (Note 12)	-	
Stockholders' equity:		
Preferred stock, $.01 par value; 1,250 shares authorized, no shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	-	-
Common stock, $.01 par value; 60,000 shares authorized, 14,658 and 14,627 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	146	146
Additional paid-in-capital	65,171	61,735
Accumulated other comprehensive loss	(5,736)	(7,317)

Retained earnings	184,557	168,209
Total stockholders' equity	244,138	222,773
Total liabilities and stockholders' equity	$265,004	$ 240,246

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

Anika Therapeutics, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Product revenue	$ 28,340	$ 26,575	$ 51,721	$ 48,853
Licensing, milestone and contract revenue	5,122	6	5,127	11
Total revenue	33,462	26,581	56,848	48,864
Operating expenses:				
Cost of product revenue	6,315	6,065	12,398	11,490
Research and development	4,449	2,792	8,679	4,951
Selling, general and administrative	4,972	4,255	10,039	8,245
Total operating expenses	15,736	13,112	31,116	24,686
Income from operations	17,726	13,469	25,732	24,178
Interest income, net	16	49	74	121
Income before income taxes	17,742	13,518	25,806	24,299
Provision for income taxes	6,373	4,903	8,944	8,789
Net income	$ 11,369	$ 8,615	$ 16,862	$ 15,510
Basic net income per share:				
Net income	$ 0.78	$ 0.59	$ 1.16	$ 1.05
Basic weighted average common shares outstanding	14,588	14,679	14,582	14,778
Diluted net income per share:				
Net income	$ 0.76	$ 0.57	$ 1.12	$ 1.02
Diluted weighted average common shares outstanding	15,044	15,111	15,046	15,210
Net income	$ 11,369	$ 8,615	$ 16,862	$ 15,510
Other comprehensive income (loss):				
Foreign currency translation adjustment	1,289	(536)	1,581	238
Comprehensive income	$ 12,658	$ 8,079	$ 18,443	$ 15,748

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

Anika Therapeutics, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	$ 16,862	$ 15,510
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,022	1,901
Stock-based compensation expense	2,465	1,478
Deferred income taxes	589	(252)
Provision for doubtful accounts	(1)	52
Provision for inventory	287	181
Changes in operating assets and liabilities:		
Accounts receivable	(2,449)	(2,932)
Inventories	(1,741)	(2,438)
Prepaid expenses, other current and long-term assets	(155)	186
Accounts payable	2,362	(4,252)
Accrued expenses and other current liabilities	(182)	446
Income taxes	2,303	(3,169)
Other long-term liabilities	(631)	351
Net cash provided by operating activities	21,731	7,062
Cash flows from investing activities:		
Proceeds from maturity of investments	20,000	27,750
Purchase of investments	(24,500)	(22,499)
Purchase of property and equipment	(3,917)	(9,869)
Net cash used in investing activities	(8,417)	(4,618)
Cash flows from financing activities:		
Repurchases of common stock	-	(25,000)
Proceeds from exercise of equity awards	209	922
Net cash provided by (used in) financing activities	209	(24,078)
Exchange rate impact on cash	90	52
Increase (decrease) in cash and cash equivalents	13,613	(21,582)
Cash and cash equivalents at beginning of period	104,261	110,707
Cash and cash equivalents at end of period	$ 117,874	$ 89,125
Supplemental disclosure of cash flow information:		
Non-cash Investing Activities:		

Purchases of property and equipment included in accounts payable and accrued expenses	$ 1,193	$ 2,128
Build-to-suit lease agreement	$ -	$ 482

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

ANIKA THERAPEUTICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share and per share amounts or as otherwise noted)

(**unaudited**)

1. Nature of Business

Anika Therapeutics, Inc. (the "Company") is a global, integrated orthopedic medicines company committed to improving the lives of patients with degenerative orthopedic diseases and traumatic conditions with clinically meaningful therapies along the continuum of care, from palliative pain management to regenerative cartilage repair. The Company has over two decades of global expertise developing, manufacturing, and commercializing products based on the Company's proprietary Hyaluronic Acid ("HA") technology. The Company's orthopedic medicine portfolio includes ORTHOVISC, MONOVISC, and CINGAL, which alleviate pain and restore joint function by replenishing depleted HA, and HYALOFAST, a solid HA-based scaffold to aid cartilage repair and regeneration.

The Company is subject to risks common to companies in the biotechnology and medical device industries including, but not limited to, development by the Company or its competitors of new technological innovations, dependence on key personnel, protection of proprietary technology, commercialization of existing and new products, and compliance with U.S. Food and Drug Administration ("FDA") and foreign regulations and approval requirements, as well as the ability to grow the Company's business through appropriate commercial strategies.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and related notes have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and in accordance with accounting principles generally accepted in the United States ("US GAAP"). The financial statements include the accounts of Anika Therapeutics, Inc. and its subsidiaries. Inter-company transactions and balances have been eliminated. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to SEC rules and regulations relating to interim financial statements. The December 31, 2016 balances reported herein are derived from the audited consolidated financial statements. In the opinion of management, these unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to fairly state the condensed consolidated financial position of the Company as of June 30, 2017, the results of its operations for the three- and six-month periods ended June 30, 2017 and 2016, and cash flows for the six-month periods ended June 30, 2017 and 2016.

The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the Company's annual financial statements filed with its Annual Report on Form 10-K for the year ended December 31, 2016. The results of operations for the six-month periods ended June 30, 2017 are not necessarily indicative of the results to be expected for the year ending December 31, 2017. Certain prior period amounts have been reclassified to conform to the current period presentation. This change in classification does not materially affect previously reported cash flows from operations or from financing activities in the Condensed Consolidated Statement of Cash Flows, and had no effect on the previously reported Condensed Consolidated Statement of Operations and Comprehensive Income.

3. Recent Accounting Pronouncements

Recently Issued

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB issued a one-year deferral of ASU 2014-09 making it effective for annual reporting periods beginning on or after December 15, 2017, while also providing for early adoption not to occur before the original effective date. The Company currently intends to adopt the new standard on a modified retrospective basis with the cumulative effect of the change reflected in retained earnings as of January 1, 2018 and to not restate prior periods. The Company has commenced work to assess the impact of the new revenue standard on its principal revenue streams. The Company has not made a determination as to the impact the adoption will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842). ASU 2016-02 amends existing lease accounting requirements. The most significant change will result in the recognition of lease assets and lease liabilities by lessees for virtually all leases. The new guidance will also require significant additional disclosures about the amount, timing, and uncertainty of cash flows from leases. ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Upon adoption, entities are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Early adoption is permitted, and a number of optional practical expedients may be elected to simplify the impact of adoption. The Company is assessing ASU 2016-02 and the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments* (Topic 326) Credit Losses. ASU 2016-13 changes the impairment model for most financial assets and certain other instruments. Under the new standard, entities holding financial assets and net investment in leases that are not accounted for at fair value through net income are to be presented at the net amount expected to be collected. An allowance for credit losses will be a valuation account that will be deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected on the financial asset. ASU 2016-13 is effective as of January 1, 2020. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements or footnote disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles-Goodwill and Other* (Topic 350) Simplifying the Test for Goodwill Impairment. ASU 2017-04 will simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Current guidance requires that companies compute the implied fair value of goodwill under Step 2 by performing procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. This standard will require companies to perform annual or interim goodwill impairment tests by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This standard will be effective for annual periods beginning after December 15, 2019, including interim periods occurring after that date, and will be applied prospectively. Early adoption of this standard is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements or footnote disclosures.

Recently Adopted

In March 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation* (Topic 718). ASU 2016-09 identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. ASU 2016-09 is effective as of January 1, 2017. Since January 1, 2017, the Company has recognized excess tax benefits and tax deficiencies related to share-based payments in the Condensed Consolidated Statements of Operations and Comprehensive Income as a component of the provision for income taxes on a prospective basis. Such excess tax benefits and tax deficiencies were previously recorded in equity. The Company also began presenting tax-related cash flows resulting from share-based payments as operating activities in the Condensed Consolidated Statements of Cash Flows, and revised retrospectively prior periods to reflect this provision. Accordingly, the Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2016 was revised by increasing net cash provided by operating activities by $0.4 million and by decreasing net cash used in financing activities by $0.4 million. Lastly, as of January 1, 2017, the Company elected to recognize forfeitures as they occur rather than estimate forfeitures each period on a modified retrospective basis. See Notes 6 and 14 for additional information regarding the impacts on the condensed consolidated financial statements.

4. Investments

All of the Company's investments are classified as available-for-sale and are carried at fair value with unrealized gains and losses recorded as a component of accumulated other comprehensive income, net of related income taxes. The Company held bank certificates of deposit of $25.0 million and $20.5 million at June 30, 2017 and December 31, 2016, respectively. There were no unrealized gains or losses on the Company's available-for-sale securities at June 30, 2017 or December 31, 2016.

5. Fair Value Measurements

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants based on assumptions that market participants would use in pricing an asset or liability. As a basis for classifying the fair value measurements, a three-tier fair value hierarchy, which classifies the fair value measurements based on the inputs used in measuring fair value, was established as follows: (Level 1) observable inputs such as quoted prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs that are observable either directly or indirectly; and (Level 3) significant unobservable inputs for which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company records its investments at fair value.

The Company's investments are all classified within Level 2 of the fair value hierarchy. These investments classified within Level 2 of the fair value hierarchy are valued based on matrix pricing compiled by third party pricing vendors, using observable market inputs such as interest rates, yield curves, and credit risk.

The fair value hierarchy of the Company's cash equivalents and investments at fair value is as follows:

	June 30, 2017	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$ 66,244	$ -	$ 66,244	$ -
Investments:				
Bank certificates of deposit	$ 25,000	$ -	$ 25,000	$ -

	December 31, 2016	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$ 68,352	$ -	$ 68,352	$ -
Bank certificates of deposit	750	-	750	-
Total cash equivalents	$ 69,102	$ -	$ 69,102	$ -
Investments:				
Bank certificates of deposit	$ 20,500	$ -	$ 20,500	$ -

6. Equity Incentive Plan

The Company estimates the fair value of stock options and stock appreciation rights ("SARs") using the Black-Scholes valuation model. Fair value of restricted stock awards ("RSAs") and restricted stock units ("RSUs") are measured by the grant-date price of the Company's shares. The fair value of each stock option award during the six-month periods ended June 30, 2017 and 2016, respectively, was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions:

	Six Months Ended June 30,	
	2017	2016
Risk free interest rate	1.65% - 1.78%	0.94% - 1.40%
Expected volatility	42.54% - 44.30%	49.47% - 51.61%
Expected life (years)	4	4.5
Expected dividend yield	0.00%	0.00%

The Company recorded $1.3 million and $0.7 million of share-based compensation expense for the three-month period ended June 30, 2017 and 2016, respectively, for equity compensation awards. The Company recorded $2.5 million and $1.5 million of share-based compensation expense for the six-month periods ended June 30, 2017 and 2016, respectively, for equity compensation awards. The Company presents the expenses related to share-based compensation awards in the same expense line items as cash compensation paid to each of its employees as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Cost of product revenue	$ 102	$ 12	$ 199	$ 25
Research and development	153	41	163	143
Selling, general and administrative	1,029	608	2,103	1,310
Total stock-based compensation expense	$ 1,284	$ 661	$ 2,465	$ 1,478

On June 13, 2017, the Company's shareholders approved the Anika Therapeutics, Inc. 2017 Omnibus Incentive Plan (the "2017 Plan"). The 2017 Plan replaced the Anika Therapeutics, Inc. Second Amended and Restated 2003 Stock Option and Incentive Plan, as amended, (the "2003 Plan"), as the plan under which future grants to employees, directors, officers, and consultants will be made. The 2017 Plan was originally approved by the Company's Board of Directors on March 31, 2017. The terms of the 2017 Plan provide for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, and performance awards that may be settled in cash, stock, or other property. Subject to adjustment for specified types of changes in our capitalization, no more than 1.2 million shares of common stock may be issued under the 2017 Plan.

During the three-month period ended June 30, 2017, a total of 2,500 stock options were granted under the 2017 Plan and a total of 3,000 stock options were granted under the 2003 Plan. During the six-month period ended June 30, 2017, a total of 2,500 stock options were granted under the 2017 Plan and a total of 0.4 million stock options were granted under the 2003 Plan. The stock options granted to employees become exercisable or vest ratably over a three-year period. In addition, the Company executed its annual grant of RSUs to non-employee directors, and these RSUs vest over a one-year period.

A portion of the stock options granted under the 2003 Plan during the six-month period ended June 30, 2017 contained certain performance criteria in addition to time-based vesting conditions. For performance-based awards with financial achievement targets, the Company recognizes expense using the graded vesting methodology based on the number of shares expected to vest. Compensation cost associated with performance grants is estimated using the Black-Scholes valuation method multiplied by the expected number of shares to be issued, which is adjusted based on the estimated probabilities of achieving the performance goals. Changes to the probability assessment and the estimated shares expected to vest will result in adjustments to the related share-based compensation expense that will be recorded in the period of the change. If the performance targets are not achieved, no compensation cost is recognized and any previously recognized compensation cost is reversed.

In connection with the adoption of ASU 2016-09, as of January 1, 2017, the Company elected to recognize forfeitures as they occur rather than estimate forfeitures each period, which was applied on a modified retrospective basis. Accordingly, the Company recognized a cumulative adjustment to retained earnings at the beginning of period ended June 30, 2017, resulting in a reduction of $0.5 million.

7. Earnings Per Share ("EPS")

Basic EPS is calculated by dividing net income by the weighted average number of shares outstanding during the period. Unvested restricted shares, although legally issued and outstanding, are not considered outstanding for purposes of calculating basic earnings per share. Diluted EPS is calculated by dividing net income by the weighted average number of shares outstanding plus the dilutive effect, if any, of outstanding stock options, SARs, RSAs, and RSUs using the treasury stock method.

The following table provides share information used in the calculation of the Company's basic and diluted earnings per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Shares used in the calculation of basic earnings per share	14,588	14,679	14,582	14,778
Effect of dilutive securities:				
Stock options, SARs, and RSAs	456	432	464	432
Diluted shares used in the calculation of earnings per share	15,044	15,111	15,046	15,210

Equity awards of 0.7 million shares were outstanding for the three- and six-month periods ended June 30, 2017 and were not included in the computation of diluted EPS because the awards' impact on EPS would have been anti-dilutive. Equity awards of 0.3 million shares were outstanding for the three- and six-month periods ended June 30, 2016 and were not included in the computation of diluted EPS because the awards' impact on EPS would have been anti-dilutive.

On February 26, 2016, the Company entered into an accelerated stock repurchase agreement with Morgan Stanley & Co. LLC ("Morgan Stanley") pursuant to a Fixed Dollar Accelerated Share Repurchase Transaction ("ASR Agreement") to purchase $25.0 million of shares of its common stock. Pursuant to the terms of the ASR Agreement, the Company paid Morgan Stanley $25.0 million in cash and received delivery of 0.4 million shares of the Company's common stock on February 29, 2016 based on a closing market price of $46.40 per share and the applicable contractual discount.

On August 26, 2016, the Company settled the approximately $7.5 million remaining under the ASR Agreement, which was recorded as an equity forward sale contract and was included in additional paid-in capital in stockholders' equity in the condensed consolidated balance sheets as it met the criteria for equity accounting. Pursuant to the terms of the ASR Agreement, the final number of shares and the average purchase price was determined at the end of the applicable purchase period, which was August 26, 2016. Based on the volume-weighted average price since the effective date of the ASR Agreement less the applicable contractual discount, Morgan Stanley delivered 0.1 million additional shares to the Company on August 31, 2016. In total, 0.5 million shares were repurchased under the ASR Agreement at an average repurchase price of $47.08 per share. These shares are held by the Company as authorized but unissued shares pursuant to Massachusetts law. The initial and final delivery of shares resulted in immediate reductions of the outstanding shares used to calculate the weighted-average common shares outstanding for basic and diluted net income per share.

8. Inventories

Inventories consist of the following:

	June 30, 2017	December 31, 2016
Raw materials	$6,287	$ 5,884
Work-in-process	6,466	5,559
Finished goods	4,831	4,540
Total	$17,584	$ 15,983

9. Intangible Assets

Intangible assets as of June 30, 2017 and December 31, 2016 consist of the following:

	June 30, 2017					December 31, 2016
	Gross Value	Useful Life	Accumulated Currency Translation Adjustment	Accumulated Amortization	Net Book Value	Net Book Value
Developed technology	$ 17,100	15	$(2,879)	$ (7,251)	$6,970	$ 6,842
In-process research & development	4,406	Indefinite	(1,174)	-	3,232	2,973
Distributor relationships	4,700	5	(415)	(4,285)	-	-
Patents	1,000	16	(172)	(404)	424	412
Elevess trade name	1,000	9	-	(1,000)	-	-
Total	$ 28,206		$(4,640)	$ (12,940)	$10,626	$ 10,227

The aggregate amortization expense related to intangible assets was $0.2 million and $0.3 million for the three-month periods ended June 30, 2017 and 2016, respectively. The aggregate amortization expense related to intangible assets was $0.5 million and $0.6 million for the six-month periods ended June 30, 2017 and 2016, respectively.

10. Goodwill

Through June 30, 2017, there have not been any events or changes in circumstances that indicate that the carrying value of goodwill may not be recoverable. Changes in the carrying value of goodwill were as follows:

	Six Months Ended June 30, 2017	Twelve Months Ended December 31, 2016
Balance, beginning	$ 7,214	$ 7,482
Effect of foreign currency adjustments	622	(268)
Balance, ending	$ 7,836	$ 7,214

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11. Accrued Expenses

Accrued expenses consist of the following:

	June 30, 2017	December 31, 2016
Compensation and related expenses	$ 2,977	$ 3,089
Facility construction costs	-	804
Research grants	399	463
Professional fees	1,015	802
Clinical trial costs	659	227
Deferred Rent	68	231
Other	555	880
Total	$ 5,673	$ 6,496

12. Commitments and Contingencies

In certain of its contracts, the Company warrants to its customers that the products it manufactures conform to the product specifications as in effect at the time of delivery of the specific product. The Company may also warrant that the products it manufactures do not infringe, violate, or breach any U.S. or international patent or intellectual property right, trade secret, or other proprietary information of any third party. On occasion, the Company contractually indemnifies its customers against any and all losses arising out of, or in any way connected with, any claim or claims of breach of its warranties or any actual or alleged defect in any product caused by the negligent acts or omissions of the Company. The Company maintains a products liability insurance policy that limits its exposure to these risks. Based on the Company’s historical activity, in combination with its liability insurance coverage, the Company believes the estimated fair value of these indemnification agreements is immaterial. The Company had no accrued warranties at June 30, 2017 or December 31, 2016 and has no history of claims paid.

The Company is also involved in various legal proceedings arising in the normal course of business. Although the outcomes of these legal proceedings are inherently difficult to predict, the Company does not expect the resolution of these legal proceedings to have a material adverse effect on its financial position, results of operations, or cash flow.

13. Leases

On October 9, 2015, Anika S.r.l. entered into a build-to-suit lease agreement with Consorzio Zona Industriale E Porto Fluviale di Padova ("ZIP"), as landlord, pursuant to which Anika S.r.l. leases a new European headquarters facility, consisting of approximately 33,000 square feet of general office, research and development, training, and warehousing space located in Padova, Italy. The lease has an initial term of fifteen years, which commenced on March 1, 2017. The lease will automatically renew for up to three additional six-year terms, subject to certain terms and conditions. The Company has the ability to withdraw from this lease subject to certain financial penalties after six years and with no penalties after the ninth year. Beginning on the commencement date, the lease provides for an initial yearly rent of approximately $0.3 million.

Construction of the new facility commenced during the first quarter of 2016. During the period of construction the Company was the deemed owner of the facility. Accordingly, the landlord's costs of constructing the facility were capitalized, as a non-cash transaction, offset by a corresponding facility lease obligation in the Company's consolidated balance sheet. When the construction concluded on March 1, 2017, the Company removed the construction-in-process asset of $3.1 million and related liability from its condensed consolidated balance sheet. The Company commissioned ZIP for additional tenant improvements of $0.8 million, which are recorded within Long-term deposits and other on the condensed consolidated balance sheet and which will be amortized over the life of the lease. The lease is accounted for as an operating lease based on the Company's assessment of the applicable accounting principles.

14. Income Taxes

Provisions for income taxes were $6.4 million and $8.9 million for the three- and six-month periods ended June 30, 2017, based on effective tax rates of 35.9% and 34.7%, respectively. Provisions for income taxes were $4.9 million and $8.8 million for the three- and six-month periods ended June 30, 2016, based on effective tax rates of 36.3% and 36.2%, respectively. The increase in income taxes for the three- and six-month periods ended June 30, 2017 resulted from increased income before income taxes offset by a net decrease in the effective tax rate as compared to the same period in the prior year. The net decrease in the effective tax rate for the three- and six-month periods ended June 30, 2017, as compared to the same periods in 2016, was primarily due to the increase in the expected research and development and state investment tax credits. In addition, the Company realized windfall tax benefits related to share-based payments in connection with the adoption of ASU 2016-09 during the period. The amount of excess tax benefits recognized as a discrete period income tax benefit was nominal and $0.3 million for the three- and six-month periods ended June 30, 2017, respectively, which decreased the effective tax rate for the interim period by 0.0% and 1.2%, respectively. Prior to the adoption of ASU 2016-09 excess tax benefits and deficiencies were previously recorded in equity. The amount of excess tax benefits recognized through additional paid-in-capital was $0.1 million and $0.4 million for the three- and six-month periods ended June 30, 2016, respectively.

The Company files income tax returns in the United States on a federal basis, in certain U.S. states, and in Italy. The associated tax filings remain subject to examination by applicable tax authorities for a certain length of time following the tax year to which those filings relate. The Company's 2014 filing has been audited by the IRS and closed. The Company's 2012 filing has been audited by the Italian tax authorities and closed.

In connection with the preparation of the financial statements, the Company performed an analysis to ascertain if it was more likely than not that it would be able to utilize, in future periods, the net deferred tax assets associated with its net operating loss carry-forward. The Company has concluded that the positive evidence outweighs the negative evidence and, thus, that the deferred tax assets not otherwise subject to a valuation allowance are realizable on a "more likely than not" basis. As such, the Company did not record a valuation allowance at June 30, 2017 or December 31, 2016.

15. Depuy Synthes Mitek Sports Medicine Monovisc Agreement

In December 2011, the Company entered into a fifteen-year licensing agreement with DePuy Synthes Mitek Sports Medicine, to exclusively market MONOVISC in the U.S. The Company fully recognized revenue for a milestone payment of $5.0 million as a result of MONOVISC achieving $100.0 million in U.S. end-user sales within a consecutive 12-month period ending in June 2017.

16. Segment and Geographic Information

The Company has one reportable operating segment, for the purposes of assessing performance and determining the allocation of resources.

Product revenue by product group is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Orthobiologics	$ 24,468	$ 23,304	$ 44,695	$ 42,891
Surgical	1,335	1,433	2,631	2,751
Dermal	453	582	878	963
Other	2,084	1,256	3,517	2,248
Product Revenue	$ 28,340	$ 26,575	$ 51,721	$ 48,853

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Total revenue by geographic location and as a percentage of overall total revenue for the three- and six-month periods ended June 30, 2017 and 2016 are as follows:

	Three Months Ended June 30,					
	2017			2016		
	Total Revenue	Percentage of Revenue		Total Revenue	Percentage of Revenue	
Geographic Location:						
United States	$27,447	82	%	$21,895	82	%
Europe	4,060	12	%	2,977	11	%
Other	1,955	6	%	1,709	7	%
Total Revenue	$33,462	100	%	$26,581	100	%

	Six Months Ended June 30,					
	2017			2016		
	Total Revenue	Percentage of Revenue		Total Revenue	Percentage of Revenue	
Geographic Location:						
United States	$46,377	82	%	$39,906	82	%
Europe	6,889	12	%	5,542	11	%
Other	3,582	6	%	3,416	7	%
Total Revenue	$56,848	100	%	$48,864	100	%

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with our financial statements and related notes appearing elsewhere in this report. In addition to historical information, this report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 concerning our business, consolidated financial condition, and results of operations. The Securities and Exchange Commission ("SEC") encourages companies to disclose forward-looking statements so that investors can better understand a company's future prospects and make informed investment decisions. Forward-looking statements are subject to risks and uncertainties, many of which are outside our control, which could cause actual results to differ materially from these statements. Therefore, you should not rely on any of these forward-looking statements. Forward-looking statements can be identified by such words as "will," "likely," "may," "believe," "expect," "anticipate," "intend," "seek," "designed," "develop," "would," "future," "can," "could," and other expressions that are predictions of or indicate future events and trends and that do not relate to historical matters. All statements other than statements of historical facts included in this report regarding our strategies, prospects, financial condition, operations, costs, plans, and objectives are forward-looking statements. Examples of forward-looking statements include, among others, statements regarding expected future operating results, expectations regarding the timing and receipt of regulatory results, anticipated levels of capital expenditures, and expectations of the effect on our financial condition of claims, litigation, and governmental and regulatory proceedings.

Please also refer to those factors described in Part II, Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2016 for important factors that we believe could cause actual results to differ materially from those in our forward-looking statements. Any forward-looking statement made by us in this Quarterly Report on Form 10-Q is based only on information currently available to us and speaks only as of the date on which it is made. We undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise.

Management Overview

We are a global, integrated orthopedic medicines company committed to improving the lives of patients with degenerative orthopedic diseases and traumatic conditions with clinically meaningful therapies along the continuum of care, from palliative pain management to regenerative cartilage repair. We have over two decades of global expertise developing, manufacturing, and commercializing our products based on our proprietary hyaluronic acid ("HA") technology. Our orthopedic medicine portfolio includes ORTHOVISC, MONOVISC, and CINGAL, which alleviate pain and restore joint function by replenishing depleted HA, and HYALOFAST, a solid HA-based scaffold to aid cartilage repair and regeneration.

Our therapeutic offerings consist of products in the following areas: Orthobiologics, Dermal, Surgical, and Other, which includes our ophthalmic and veterinary products. All of our products are based on HA, a naturally occurring,

biocompatible polymer found throughout the body. Due to its unique biophysical and biochemical properties, HA plays an important role in a number of physiological functions such as the protection and lubrication of soft tissues and joints, the maintenance of the structural integrity of tissues, and the transport of molecules to and within cells.

Our proprietary technologies for modifying the HA molecule allow product properties to be tailored specifically to therapeutic use. Our patented technology chemically modifies HA to allow for longer residence time in the body. We also offer products made from HA based on two other technologies: HYAFF, which is a solid form of HA, and ACP gel, an autocross-linked polymer of HA. Our technologies are protected by an extensive portfolio of owned and licensed patents.

Since our inception in 1992, we have utilized a commercial partnership model for the distribution of our products to end-users. Our strong, worldwide network of distributors has historically provided, and continues to provide, a solid foundation for our revenue growth and territorial expansion. In 2015, we made the strategic decision to commercialize our next generation viscosupplementation product, CINGAL, in the United States ourselves, initially through the engagement of a contract sales organization. Ultimately, we intend to transition the direct sales function into our company as part of a broader buildout of our commercial capabilities. We believe that the combination of the direct and distribution commercial models will maximize the revenue potential from our current and future product portfolio.

We began a strategic project in 2015 to move the manufacturing of our HYAFF-based products, which were previously manufactured under an existing contract manufacturing agreement with a third party in Italy, to our Bedford, Massachusetts facility. Our main purposes behind this strategic move are to improve the efficiency of our manufacturing process and to enhance our research and development capabilities, with the aim of accelerating future product development. We expect to expend approximately $25.0 million on this project. Since project inception through June 30, 2017, we have expended approximately $22.5 million on the project, and we have completed key planned project milestones to date. We expect the project to be fully completed before the end of 2017.

Please see the section captioned “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations-Management Overview” in our Annual Report on Form 10-K for the year ended December 31, 2016, for a description of each of the above therapeutic areas, including the individual products.

Research and Development

Our research and development efforts primarily consist of the development of new medical applications for our HA-based technology, the management of clinical trials for certain product candidates, the preparation and processing of applications for regulatory approvals or clearances at all relevant stages of product development, and process development and scale-up manufacturing activities for our existing and new products. Our development focus includes products for tissue protection, repair, and regeneration. We anticipate that we will continue to commit significant resources to research and development, including clinical trials in the future.

Our second single-injection osteoarthritis product under development in the United States is CINGAL, which is composed of our proprietary cross-linked HA material combined with an approved steroid and is designed to provide both short- and long-term pain relief to patients. We completed an initial CINGAL phase III clinical trial, including the associated statistical analysis for 368 enrolled patients, during the fourth quarter of 2014 with data indicating that the product met all primary and secondary endpoints relative to the placebo set forth for the trial. During the first half of 2015, we completed a CINGAL retreatment study with 242 patients who had participated in the phase III clinical trial and reported safety data related to the retreatment study. This initial phase III clinical trial and the associated retreatment study supported the Health Canada and CE Mark approval of the product, and the commercial launch of the product in both Canada and the European Union occurred in the second quarter of 2016. In the United States, after discussions with the U.S. Food and Drug Administration (“FDA”) related to the regulatory pathway for CINGAL, we conducted a formal meeting with the FDA’s Office of Combination Products (“OCP”) to present and discuss our data in September 2015, and we submitted a formal request for designation with OCP a month later. In its response to our formal request for designation, OCP assigned the product to the FDA’s Center for Drug Evaluation and Research (“CDER”) as the lead agency center for premarket review and regulation. Since then, we have been in ongoing discussions with CDER to understand the requirements for submitting a New Drug Application (“NDA”) for CINGAL. We held a meeting with CDER in September 2016 to align on an approval framework and on submission requirements for this NDA for CINGAL, including the execution of an additional Phase III clinical trial to supplement our existing CINGAL pivotal study data. We submitted an Investigational New Drug Application (“IND”) in late 2016, and discussions with CDER indicated no objections to our clinical protocol design. As a result, we commenced work on this second Phase III clinical trial in the first quarter of 2017, and the first patient was treated in the second quarter of 2017. We expect to complete enrollment of this clinical trial by the end of 2017.

We have several research and development programs underway for new products, including for HYALOFAST (in the United States), an innovative product for cartilage tissue repair, HYALOBONE, a bone void filler, and other early stage regenerative medicine development programs. HYALOFAST received CE Mark approval in September 2009, and it is commercially available in Europe and certain international countries. During the first quarter of 2015, we submitted an Investigational Device Exemption (“IDE”) for HYALOFAST to the FDA, which was approved in July

2015. We commenced patient enrollment in a clinical trial in December 2015, and we are advancing site initiations and patient enrollment activities. In the second quarter of 2016, a supplement to the HYALOFAST IDE was approved to expand the inclusion criteria for the clinical study. The purpose of this supplement is to allow us to increase enrollment rates with the ultimate goal of decreasing the time needed to complete the clinical trial. In addition, we are currently proceeding with other research and development programs, one of which utilizes our proprietary HA technology to treat pain associated with common repetitive overuse injuries, such as lateral epicondylitis, also known as tennis elbow. We submitted a CE Mark application for this treatment during the first quarter of 2016 and received a CE Mark for the treatment of pain associated with tennis elbow in December 2016. Outside of the United States, this product will be marketed under the trade name ORTHOVISC-T. In the second quarter of 2016, we submitted an IDE to the FDA to conduct a phase III clinical trial for this treatment, which was approved by the FDA in June 2016. We also have other research and development programs underway focused on expanding the indications of our current products, including one program being conducted and funded by our U.S. MONOVISC distribution partner, DePuy Synthes Mitek Sports Medicine (“Mitek”), seeking to expand MONOVISC’s indication to include treatment of pain associated with osteoarthritis of the hip.

In June 2015, we entered into an agreement with the Institute for Applied Life Sciences at the University of Massachusetts Amherst to collaborate on research to develop a therapy for rheumatoid arthritis. The purpose of this research is to develop a novel modality for the treatment of rheumatoid arthritis and, if successful, it is expected to yield a potential product candidate that we could begin to move towards commercialization through additional pre-clinical studies as early as the second half of 2017.

Results of Operations

Three- and Six-Months Ended June 30, 2017 Compared to Three- and Six-Months Ended June 30, 2016

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	$ Inc/(Dec)	% Inc/(Dec)	2017	2016	$ Inc/(Dec)	% Inc/(Dec)
	(in thousands, except percentages)				(in thousands, except percentages)			
Product revenue	$28,340	$26,575	$ 1,765	7 %	$51,721	$48,853	$ 2,868	6 %
Licensing, milestone and contract revenue								