

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC. 20549

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

for the Quarterly Period ended September 30, 2016

or

**Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

for the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-19437

**TRANSENERIX, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**11-2962080**

(I.R.S. employer  
identification no.)

**635 Davis Drive, Suite 300, Morrisville, NC**

(Address of principal executive offices)

**27560**

(Zip code)

**Registrant's telephone number, including area code: (919) 765-8400**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

115,058,244 shares of the Company's common stock, par value \$0.001 per share, were outstanding as of November 4, 2016.

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In addition to historical financial information, this report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) that concern matters that involve risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. These forward-looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact contained in this report, including statements regarding future events, our future financial performance, our future business strategy and the plans and objectives of management for future operations, are forward-looking statements. We have attempted to identify forward-looking statements by terminology including “anticipates,” “believes,” “can,” “continue,” “could,” “estimates,” “expects,” “intends,” “in the event that,” “may,” “plans,” “potential,” “predicts,” “should” or “will” or the negative of these terms or other comparable terminology. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by us, which attempt to advise interested parties of the risks, uncertainties, and other factors that affect our business, operating results, financial condition and stock price, including without limitation the disclosures made under the captions “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Financial Statements,” “Notes to Consolidated Financial Statements” and “Risk Factors” in this report, as well as the disclosures made in the TransEnterix, Inc. Annual Report on Form 10-K for the year ended December 31, 2015 filed on March 3, 2016, and other filings we make with the Securities and Exchange Commission. Furthermore, such forward-looking statements speak only as of the date of this report. We expressly disclaim any intent or obligation to update any forward-looking statements after the date hereof to conform such statements to actual results or to changes in our opinions or expectations except as required by applicable law. References in this report to “we”, “our”, “us”, or the “Company” refer to TransEnterix, Inc. and the combined enterprise of SafeStitch Medical, Inc., TransEnterix Surgical, Inc., TransEnterix International, Inc., TransEnterix Italia S.r.l, TransEnterix Europe S.Á.R.L, TransEnterix Europe S.Á.R.L, Bertrange, Swiss Branch, Lugano and TransEnterix Asia PTE. LTD.

**TransEnterix, Inc.**  
**Consolidated Statements of Operations and Comprehensive Loss**  
(in thousands except per share amounts)  
**(Unaudited)**

|   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|-------------|------------------------------------|-------------|
|   | 2016                                | 2015        | 2016                               | 2015        |
| Revenue   | \$ 1,466                            | \$ —        | \$ 1,466                           | \$ —        |
| Cost of revenue   | 1,031                               | —           | 1,031                              | —           |
| Gross profit  | 435                                 | —           | 435                                | —           |
| Operating Expenses  |                                     |             |                                    |             |
| Research and development  | 7,011                               | 7,048       | 21,760                             | 21,111      |
| Sales and marketing   | 2,574                               | 413         | 5,563                              | 1,161       |
| General and administrative  | 2,793                               | 1,762       | 7,927                              | 5,607       |
| Amortization of intangible assets                                 | 1,709                               | 338         | 5,312                              | 589         |
| Change in fair value of contingent consideration                  | (100)                               | —           | 1,700                              | —           |
| Inventory write-down related to restructuring                     | —                                   | —           | 2,565                              | —           |
| Restructuring and other charges                                   | —                                   | —           | 3,085                              | —           |
| Goodwill impairment   | —                                   | —           | 61,784                             | —           |
| Acquisition related costs   | —                                   | 4,003       | —                                  | 4,003       |
| Total Operating Expenses  | 13,987                              | 13,564      | 109,696                            | 32,471      |
| Operating Loss  | (13,552)                            | (13,564)    | (109,261)                          | (32,471)    |
| Other Expense   |                                     |             |                                    |             |
| Interest expense, net   | (432)                               | (436)       | (1,499)                            | (997)       |
| Other (expense) income  | (30)                                | —           | 65                                 | —           |
| Total Other Expense, net  | (462)                               | (436)       | (1,434)                            | (997)       |
| Loss before income taxes  | \$ (14,014)                         | \$ (14,000) | \$ (110,695)                       | \$ (33,468) |
| Income tax benefit  | 1,070                               | 99          | 4,707                              | 99          |
| Net loss  | \$ (12,944)                         | \$ (13,901) | \$ (105,988)                       | \$ (33,369) |
| Other comprehensive gain (loss)                                   |                                     |             |                                    |             |
| Foreign currency translation gain (loss)                          | 689                                 | (429)       | 2,199                              | (429)       |
| Comprehensive loss  | \$ (12,255)                         | \$ (14,330) | \$ (103,789)                       | \$ (33,798) |
| Net loss per share - basic and diluted                            | \$ (0.11)                           | \$ (0.16)   | \$ (0.95)                          | \$ (0.46)   |
| Weighted average common shares outstanding -<br>basic and diluted | 114,946                             | 86,044      | 111,189                            | 72,713      |

*See accompanying notes to consolidated financial statements.*

**TransEnterix, Inc.**  
**Consolidated Balance Sheets**  
(in thousands, except share amounts)

|  | September 30,<br>2016<br>(unaudited) | December 31,<br>2015 |
|--|--------------------------------------|----------------------|
| <b>Assets</b>  |                                      |                      |
| <b>Current Assets</b>  |                                      |                      |
| Cash and cash equivalents  | \$ 42,518                            | \$ 38,449            |
| Accounts receivable, net   | 616                                  | 76                   |
| Inventories  | 2,250                                | 3,923                |
| Interest receivable  | 15                                   | 6                    |
| Other current assets   | 8,149                                | 6,689                |
| <b>Total Current Assets</b>  | <b>53,548</b>                        | <b>49,143</b>        |
| Restricted cash  | 10,353                               | —                    |
| Accounts receivable, net of current portion  | 274                                  |                      |
| Inventories, net of current portion  | —                                    | 709                  |
| Property and equipment, net  | 4,614                                | 4,408                |
| Intellectual property, net   | 41,260                               | 46,898               |
| In-process research and development  | 16,972                               | 16,511               |
| Goodwill   | 69,948                               | 130,869              |
| Other long term assets   | 63                                   | 64                   |
| <b>Total Assets</b>  | <b>\$ 197,032</b>                    | <b>\$ 248,602</b>    |
| <b>Liabilities and Stockholders' Equity</b>  |                                      |                      |
| <b>Current Liabilities</b>   |                                      |                      |
| Accounts payable   | \$ 2,596                             | \$ 4,450             |
| Accrued expenses   | 7,246                                | 7,395                |
| Contingent consideration – current portion   | 11,325                               | 12,500               |
| Notes payable - current portion  | 7,826                                | 6,727                |
| <b>Total Current Liabilities</b>   | <b>28,993</b>                        | <b>31,072</b>        |
| <b>Long Term Liabilities</b>   |                                      |                      |
| Contingent consideration – less current portion  | 13,875                               | 11,000               |
| Net deferred tax liabilities   | 11,971                               | 16,263               |
| Notes payable - less current portion, net of debt discount   | 7,059                                | 12,990               |
| <b>Total Liabilities</b>   | <b>61,898</b>                        | <b>71,325</b>        |
| <b>Commitments and Contingencies</b>   |                                      |                      |
| <b>Stockholders' Equity</b>  |                                      |                      |
| Common stock \$0.001 par value, 750,000,000 shares authorized at September 30, 2016 and December 31, 2015; 115,086,256 and 100,180,872 shares issued at September 30, 2016 and December 31, 2015, respectively; and 115,014,711 and 100,149,453 shares outstanding at September 30, 2016 and December 31, 2015, respectively | 115                                  | 100                  |
| Additional paid-in capital   | 425,041                              | 363,280              |
| Accumulated deficit  | (288,852)                            | (182,864)            |
| Treasury stock at cost, 71,545 and 31,419 shares at September 30, 2016 and December 31, 2015, respectively   | (203)                                | (73)                 |
| Accumulated other comprehensive loss   | (967)                                | (3,166)              |
| <b>Total Stockholders' Equity</b>  | <b>135,134</b>                       | <b>177,277</b>       |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$ 197,032</b>                    | <b>\$ 248,602</b>    |

*See accompanying notes to consolidated financial statements.*

**TransEnterix, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
(in thousands)  
(Unaudited)

|  | Common Stock |        | Treasury Stock |          | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|--|--------------|--------|----------------|----------|----------------------------------|------------------------|---|----------------------------------|
|  | Shares       | Amount | Shares         | Amount   |                                  |                        |   |                                  |
| <b>Balance, December 31, 2015</b>                                      | 100,180      | \$ 100 | (31)           | \$ (73)  | \$ 363,280                       | \$ (182,864)           | \$ (3,166)                                    | \$ 177,277                       |
| Stock-based compensation   | —            | —      | —              | —        | 3,858                            | —                      | —   | 3,858                            |
| Issuance of common stock, net of<br>issuance costs                     | 14,474       | 15     | —              | —        | 57,622                           | —                      | —   | 57,637                           |
| Exercise of stock options and restricted<br>stock units                | 351          | —      | —              | —        | 165                              | —                      | —   | 165                              |
| Return of common stock to pay<br>withholding taxes on restricted stock | —            | —      | (41)           | (130)    | —                                | —                      | —   | (130)                            |
| Issuance of common stock for services                                  | 81           | —      | —              | —        | 116                              | —                      | —   | 116                              |
| Other comprehensive gain   | —            | —      | —              | —        | —                                | —                      | 2,199   | 2,199                            |
| Net loss   | —            | —      | —              | —        | —                                | (105,988)              | —   | (105,988)                        |
| <b>Balance, September 30, 2016</b>                                     | 115,086      | \$ 115 | (72)           | \$ (203) | \$ 425,041                       | \$ (288,852)           | \$ (967)                                      | \$ 135,134                       |

*See accompanying notes to consolidated financial statements.*

**TransEnterix, Inc.**  
**Consolidated Statements of Cash Flows**  
(in thousands)  
(Unaudited)

|  | Nine Months Ended<br>September 30, |                  |
|--|------------------------------------|------------------|
|  | 2016                               | 2015             |
| <b>Operating Activities</b>  |                                    |                  |
| Net loss   | \$ (105,988)                       | \$ (33,369)      |
| Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities: |                                    |                  |
| Depreciation   | 1,498                              | 802              |
| Amortization of intangible assets  | 5,312                              | 589              |
| Amortization of debt discount and debt issuance costs  | 140                                | 89               |
| Stock-based compensation   | 3,858                              | 2,388            |
| Common stock issued for services   | 116                                | —                |
| Inventory write-down related to restructuring  | 2,565                              | —                |
| Loss on disposal of property   | —                                  | 34               |
| Non-cash restructuring and other charges   | 2,551                              | —                |
| Goodwill impairment  | 61,784                             | —                |
| Deferred tax benefit   | (4,725)                            | (99)             |
| Change in fair value of contingent consideration   | 1,700                              | —                |
| Changes in operating assets and liabilities, net of effect of acquisition:                       |                                    |                  |
| Accounts receivable  | (809)                              | 133              |
| Interest receivable  | (9)                                | (5)              |
| Inventories  | (1,883)                            | (250)            |
| Other current and long term assets   | (1,290)                            | (248)            |
| Accounts payable   | (1,917)                            | 984              |
| Accrued expenses   | (168)                              | 4,127            |
| Restricted cash  | (10,353)                           | 250              |
| Net cash and cash equivalents used in operating activities                                       | <u>(47,618)</u>                    | <u>(24,575)</u>  |
| <b>Investing Activities</b>  |                                    |                  |
| Payment for acquisition  | —                                  | (25,000)         |
| Purchase of property and equipment   | (878)                              | (728)            |
| Net cash and cash equivalents used in investing activities                                       | <u>(878)</u>                       | <u>(25,728)</u>  |
| <b>Financing Activities</b>  |                                    |                  |
| Payment of debt  | (4,972)                            | —                |
| Proceeds from issuance of common stock, net of issuance costs                                    | 57,637                             | 58,295           |
| Proceeds from issuance of debt, net of debt discount   | —                                  | 9,886            |
| Taxes paid related to net share settlement of vesting of restricted stock units                  | (130)                              | (3)              |
| Proceeds from exercise of stock options and warrants   | 163                                | 252              |
| Net cash and cash equivalents provided by financing activities                                   | <u>52,698</u>                      | <u>68,430</u>    |
| Effect of exchange rate changes on cash and cash equivalents                                     | <u>(133)</u>                       | <u>—</u>         |
| Net increase in cash and cash equivalents  | 4,069                              | 18,127           |
| Cash and cash equivalents, beginning of period   | 38,449                             | 34,766           |
| Cash and cash equivalents, end of period   | <u>\$ 42,518</u>                   | <u>\$ 52,893</u> |
| <b>Supplemental Disclosure for Cash Flow Information</b>   |                                    |                  |
| Interest paid  | \$ 1,019                           | \$ 598           |
| <b>Supplemental Schedule of Noncash Investing Activities</b>                                     |                                    |                  |
| Transfer of inventory to property and equipment  | \$ 1,866                           | —                |
| Issuance of common stock warrants  | —                                  | \$ 96            |
| Contingent consideration related to acquisition  | —                                  | \$ 24,300        |
| Issuance of common stock related to acquisition  | —                                  | \$ 43,677        |

*See accompanying notes to consolidated financial statements.*

## 1. Organization and Capitalization

TransEnterix, Inc. (the “Company”) is a medical device company that is pioneering the use of robotics to improve minimally invasive surgery by addressing the clinical challenges associated with current laparoscopic and robotic options. The Company is focused on the commercialization and further development of its Senhance™ Surgical Robotic System (formerly known as the ALF-X® Surgical Robotic System) (the “Senhance System”), a multi-port robotic system that brings the advantages of robotic surgery to patients while enabling surgeons with innovative technology. The Company also developed the SurgiBot™ System, a single-port, robotically enhanced laparoscopic surgical platform. The Senhance System has been granted a CE Mark in Europe for laparoscopic abdominal and pelvic surgery, as well as limited thoracic operations excluding cardiac and vascular surgery, but is not available for sale in the U.S. The SurgiBot System is not available for sale in any market.

The Senhance System is a multi-port robotic surgery system which allows multiple arms to control robotic instruments and a camera. The system features advanced technology to enable surgeons with haptic feedback and the ability to move the camera via eye movement. The system replicates laparoscopic motion that is familiar to experienced surgeons, and features three-dimensional high definition (“3DHD”) vision technology. The Senhance System also offers responsible economics to hospitals by offering robotic technology with reusable instruments with minimal additional costs per surgery.

The SurgiBot System is designed to utilize flexible instruments through articulating channels controlled directly by the surgeon, with robotic assistance, while the surgeon remains patient-side within the sterile field. In June 2015, the Company submitted a 510(k) application to the FDA for the SurgiBot System. On April 19, 2016, the FDA notified the Company that the SurgiBot System did not meet the criteria for substantial equivalence based on the data and information submitted by TransEnterix in the 510(k) submission. As a result, the Company has reprioritized its near-term regulatory efforts to focus on the 510(k) submission for the Senhance System. Consequently, in May 2016, the Company implemented a restructuring plan. See Note 14 to the consolidated financial statements for further details regarding the restructuring.

On September 3, 2013, TransEnterix Surgical, Inc. a Delaware corporation (“TransEnterix Surgical”), and SafeStitch Medical, Inc., a Delaware corporation (“SafeStitch”) consummated a merger transaction whereby TransEnterix Surgical merged with a merger subsidiary of SafeStitch, with TransEnterix Surgical as the surviving entity in the merger (the “Merger”). As a result of the Merger, TransEnterix Surgical became a wholly owned subsidiary of SafeStitch. On December 6, 2013, SafeStitch changed its name to TransEnterix, Inc. and increased the authorized shares of common stock from 225,000,000 to 750,000,000, and authorized 25,000,000 shares of preferred stock, par value \$0.01 per share.

On September 18, 2015, the Company entered into a Membership Interest Purchase Agreement, (the “Purchase Agreement”) with SOFAR S.p.A., (“SOFAR”) as seller, Vulcanos S.r.l. (“Vulcanos”), as the acquired company, and TransEnterix International, Inc. (“TransEnterix International”), a direct, wholly owned subsidiary of the Company which was incorporated in September 2015, as buyer. The closing of the transactions occurred on September 21, 2015 (the “Closing Date”) pursuant to which the Company acquired all of the membership interests of Vulcanos from SOFAR (now known as the “Senhance Acquisition”), and changed the name of Vulcanos to TransEnterix Italia S.r.l (“TransEnterix Italia”). The Senhance Acquisition included all of the assets, employees and contracts related to the Senhance System. See Note 3 for a description of the related transactions.

As used herein, the term “Company” refers to the combination of SafeStitch and TransEnterix Surgical after giving effect to the Merger, and includes TransEnterix International, TransEnterix Italia, TransEnterix Europe S.Á.R.L, TransEnterix Europe S.Á.R.L, Bertrange, Swiss Branch, Lugano and TransEnterix Asia PTE. LTD. after giving effect to the Senhance Acquisition, the term “SafeStitch” refers to the historic business of SafeStitch Medical, Inc. prior to the Merger, and the term “TransEnterix Surgical” refers to the historic business of TransEnterix Surgical, Inc. prior to the Merger.

The Company operates in one business segment.



## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The Company has prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q and the standards of accounting measurement set forth in the Interim Reporting Topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). Consequently, the Company has not necessarily included in this Form 10-Q all information and footnotes required for audited financial statements. In the opinion of the Company’s management, the accompanying unaudited condensed consolidated financial statements in this Form 10-Q contain all adjustments, consisting only of normal recurring adjustments, except as otherwise indicated, necessary for a fair statement of its financial position, results of operations, and cash flows of the Company for all periods presented. The results reported in these condensed consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for any subsequent period or for the entire year. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the Company’s audited financial statements and the notes thereto included in the Company’s latest Annual Report on Form 10-K. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted in the accompanying interim consolidated financial statements. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The accompanying Consolidated Financial Statements include the accounts of the Company and its direct and indirect wholly owned subsidiaries, SafeStitch LLC, TransEnterix Surgical, Inc., TransEnterix International, Inc., TransEnterix Italia S.r.l., TransEnterix Europe S.Á.R.L, TransEnterix Europe S.Á.R.L, Bertrange, Swiss Branch, Lugano and TransEnterix Asia PTE. LTD. All inter-company accounts and transactions have been eliminated in consolidation.

### Going Concern

The accompanying consolidated financial statements have been prepared on a going concern basis. The Company has accumulated a deficit of approximately \$288.9 million as of September 30, 2016, and has not generated significant revenue or positive cash flows from operations. These factors raise substantial doubt about the Company’s ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts of liabilities that might result from the outcome of this uncertainty. To meet its capital needs, the Company is considering multiple alternatives, including, but not limited to, additional equity financings, debt financings and other funding transactions. There can be no assurance that the Company will be able to complete any such transaction on acceptable terms or otherwise. If the Company is unable to obtain the necessary capital, it will need to pursue a plan to license or sell its assets, seek to be acquired by another entity, cease operations and/or seek bankruptcy protection.

### Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include identifiable intangible assets and goodwill, stock compensation expense, excess and obsolete inventory reserves, and deferred tax asset valuation allowances.

### Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with original maturities of 90 days or less at the time of purchase to be cash equivalents and investments with original maturities of between 91 days and one year to be short-term investments. In order to manage exposure to credit risk, the Company invests in high-quality investments rated at least A2 by Moody’s Investors Service or A by Standard & Poor.

Restricted cash at September 30, 2016 includes \$10.0 million in a money market account, held in connection with the Company’s notes payable and \$353,000 in cash accounts held as collateral primarily under the terms of an office operating lease.

### Fair Value of Financial Instruments

The carrying values of cash equivalents, accounts receivable, interest receivable, accounts payable, and certain accrued expenses at September 30, 2016 and December 31, 2015, approximate their fair values due to the short-term nature of these items. The Company’s notes payable balance approximates fair value as of September 30, 2016 and December 31, 2015 as the interest rates on the notes payable approximate the rates available to the Company as of these dates.

## 2. Summary of Significant Accounting Policies (Continued)

### Concentrations and Credit Risk

The Company's principal financial instruments subject to potential concentration of credit risk are cash and cash equivalents and investments held in money market accounts. The Company places cash deposits with a federally insured financial institution. The Company maintains its cash at banks and financial institutions it considers to be of high credit quality; however, the Company's cash deposits may at times exceed the FDIC insured limit. Balances in excess of federally insured limitations may not be insured. The Company has not experienced losses on these accounts, and management believes that the Company is not exposed to significant risks on such accounts.

The Company's accounts receivable are derived from net revenue to customers and distributors located throughout the world. The Company evaluates its customers' financial condition and, generally, requires no collateral from its customers. The Company provides reserves for potential credit losses but has not experienced significant losses to date. The Company had one customer who constituted 100% of the Company's net accounts receivable at September 30, 2016 and December 31, 2015.

### Accounts Receivable

Accounts receivable are recorded at net realizable value, which includes an allowance for estimated uncollectable accounts. The allowance for uncollectible accounts was determined based on historical collection experience.

### Inventories

Inventories are stated at the lower of cost or market, on a first-in, first-out basis. Inventory costs include direct materials, direct labor, and normal manufacturing overhead. The Company records reserves, when necessary, to reduce the carrying value of inventory to its net realizable value. Management considers forecast demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining excess and obsolescence and net realizable value adjustments. At the point of loss recognition, a new, lower-cost basis for that inventory is established, and any subsequent improvements in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any inventory on hand at the measurement date in excess of the Company's current requirements based on anticipated levels of sales is classified as long-term on the Company's consolidated balance sheets. The Company's classification of long-term inventory requires it to estimate the portion of on-hand inventory that can be realized over the next 12 months.

### Identifiable Intangible Assets and Goodwill

Identifiable intangible assets are recorded at cost, or when acquired as part of a business acquisition, at estimated fair value. Certain intangible assets are amortized over 7 to 10 years. Similar to tangible personal property and equipment, the Company periodically evaluates identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Intellectual property consists of purchased patent rights and developed research and development acquired as part of a business acquisition. Amortization of the patent rights is recorded using the straight-line method over the estimated useful life of the patents of 10 years. Amortization of the developed research and development is recorded using the straight-line method over the estimated useful life of 7 years. This method approximates the period over which the Company expects to receive the benefit from these assets. See Note 10 for additional information related to the write-off of purchased patents in connection with the restructuring plan executed in May 2016. No impairment existed at December 31, 2015.

Indefinite-lived intangible assets, such as goodwill, are not amortized. The Company tests the carrying amounts of goodwill for recoverability on an annual basis at December 31 or when events or changes in circumstances indicate evidence a potential impairment exists, using a fair value based test. The Company continues to operate in one segment, which is considered to be the sole reporting unit and therefore, goodwill is tested for impairment at the enterprise level. See Note 10 for additional information related to goodwill impairment recorded during the second quarter of 2016. No impairment existed at December 31, 2015.

## 2. Summary of Significant Accounting Policies (Continued)

### In-Process Research and Development

In-process research and development (“IPR&D”) assets represent the fair value assigned to technologies that were acquired, which at the time of acquisition have not reached technological feasibility and have no alternative future use. IPR&D assets are considered to be indefinite-lived until the completion or abandonment of the associated research and development projects. During the period that the IPR&D assets are considered indefinite-lived, they are tested for impairment on an annual basis, or more frequently if the Company becomes aware of any events occurring or changes in circumstances that indicate that the fair value of the IPR&D assets are less than their carrying amounts. If and when development is complete, which generally occurs upon regulatory approval, and the Company is able to commercialize products associated with the IPR&D assets, these assets are then deemed definite-lived and are amortized based on their estimated useful lives at that point in time. If development is terminated or abandoned, the Company may have a full or partial impairment charge related to the IPR&D assets, calculated as the excess of carrying value of the IPR&D assets over fair value. The IPR&D was acquired on September 21, 2015. No impairment existed at September 30, 2016 and December 31, 2015.

### Property and Equipment

Property and equipment consists primarily of machinery, manufacturing equipment, computer equipment, furniture, and leasehold improvements, which are recorded at cost.

Depreciation is recorded using the straight-line method over the estimated useful lives of the assets as follows:

|                                       |                                       |
|---------------------------------------|---------------------------------------|
| Machinery and manufacturing equipment | 3-5 years                             |
| Computer equipment                    | 3 years                               |
| Furniture                             | 5 years                               |
| Leasehold improvements                | Lesser of lease term or 3 to 10 years |

Upon retirement or sale, the cost of assets disposed of and the related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is credited or charged to operations. Repairs and maintenance costs are expensed as incurred.

### Impairment of Long-Lived Assets

The Company reviews its long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine the recoverability of its long-lived assets, the Company evaluates the probability that future estimated undiscounted net cash flows will be less than the carrying amount of the assets. If such estimated cash flows are less than the carrying amount of the long-lived assets, then such assets are written down to their fair value. The Company’s estimates of anticipated cash flows and the remaining estimated useful lives of long-lived assets could be reduced in the future, resulting in a reduction to the carrying amount of long-lived assets.

### Contingent Consideration

Contingent consideration is recorded as a liability and is the estimate of the fair value of potential milestone payments related to business acquisitions. Contingent consideration is measured at fair value using a discounted cash flow model utilizing significant unobservable inputs including the probability of achieving each of the potential milestones and an estimated discount rate associated with the risks of the expected cash flows attributable to the various milestones. Significant increases or decreases in any of the probabilities of success or changes in expected timelines for achievement of any of these milestones would result in a significantly higher or lower fair value of these milestones, respectively, and commensurate changes to the associated liability. The fair value of the contingent consideration at each reporting date is updated by reflecting the changes in fair value in our statement of operations and comprehensive loss.

### Translation of Foreign Currencies

The functional currency of the Company’s operational foreign subsidiaries is Euros. The assets and liabilities of the Company’s foreign subsidiaries are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. The cumulative translation effect for a subsidiary using a functional currency other than the U.S. dollar is included in accumulated other comprehensive income or loss as a separate component of stockholders’ equity.

## 2. Summary of Significant Accounting Policies (Continued)

The Company's intercompany accounts are denominated in the functional currency of the foreign subsidiary. Gains and losses resulting from the remeasurement of intercompany receivables that the Company considers to be of a long-term investment nature are recorded as a cumulative translation adjustment in accumulated other comprehensive income or loss as a separate component of stockholders' equity, while gains and losses resulting from the remeasurement of intercompany receivables from a foreign subsidiary for which the Company anticipates settlement in the foreseeable future are recorded in the consolidated statement of operations and comprehensive loss. The net gains and losses included in net loss in the consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2016 and 2015 were not significant.

### Business Acquisitions

Business acquisitions are accounted for using the acquisition method of accounting in accordance with ASC 805, "Business Combinations." ASC 805 requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values, as determined in accordance with ASC 820, "Fair Value Measurements," as of the acquisition date. For certain assets and liabilities, book value approximates fair value. In addition, ASC 805 establishes that consideration transferred be measured at the closing date of the acquisition at the then-current market price. Under ASC 805, acquisition related costs (i.e., advisory, legal, valuation and other professional fees) and certain acquisition-related restructuring charges impacting the target company are expensed in the period in which the costs are incurred. The application of the acquisition method of accounting requires the Company to make estimates and assumptions related to the estimated fair values of net assets acquired.

Significant judgments are used during this process, particularly with respect to intangible assets. Generally, intangible assets are amortized over their estimated useful lives. Goodwill and other indefinite-lived intangibles are not amortized, but are annually assessed for impairment. Therefore, the purchase price allocation to intangible assets and goodwill has a significant impact on future operating results.

### Risk and Uncertainties

The Company is subject to a number of risks similar to other similarly-sized companies in the medical device industry. These risks include, without limitation, the historical lack of profitability; the Company's ability to raise additional capital; its ability to successfully integrate the Senhance System into its business; its ability to successfully develop, clinically test and commercialize its products; the timing and outcome of the regulatory review process for its products; changes in the health care and regulatory environments of the United States, Italy, other countries in the European Union, and other countries in which the Company intends to operate; its ability to attract and retain key management, marketing and scientific personnel; competition from new entrants; its ability to successfully prepare, file, prosecute, maintain, defend and enforce patent claims and other intellectual property rights; its ability to successfully transition from a research and development company to a marketing, sales and distribution concern; competition in the market for robotic surgical devices; and its ability to identify and pursue development of additional products.

### Revenue Recognition

The Company's revenue consists of product revenue resulting from the sales of systems, instruments and accessories, and service revenue. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable, and collectability is reasonably assured. Revenue is presented net of taxes collected from customers that are remitted to government authorities. The Company generally recognizes revenue at the following points in time:

- System sales.* For systems sold directly to end customers, revenue is recognized when acceptance occurs, which is deemed to have occurred upon customer acknowledgment of delivery or installation, depending on the terms of the arrangement. The Senhance Systems are delivered with a software component. However, because the software and non-software elements function together to deliver the system's essential functionality, the Company's arrangements are excluded from being accounted for under software revenue recognition guidance.

- Instruments and accessories.* Revenue from sales of instruments and accessories is generally recognized at the time of shipment.

- Service.* Service revenue is recognized ratably over the term of the service period. Revenue related to services performed on a time-and-materials basis is recognized when it is earned and billable.

## 2. Summary of Significant Accounting Policies (Continued)

The Company's system sale arrangements contain multiple elements including a system(s), instruments, accessories, and system service. The Company generally delivers all of the elements, other than service, within days of entering into the system sale arrangement. Each of these elements is a separate unit of accounting. System accessories, instruments, accessories and service are also sold on a stand-alone basis.

For multiple-element arrangements, revenue is allocated to each unit of accounting based on their relative selling prices. Relative selling prices are based first on vendor specific objective evidence of fair value ("VSOE"), then on third-party evidence of selling price ("TPE") when VSOE does not exist, and then on management's best estimate of the selling price ("BESP") when VSOE and TPE do not exist.

The Company's system sale arrangements generally include a one-year period of free service, and the right for the customer to purchase service annually thereafter. The revenue allocated to the free service period is deferred and recognized ratably over the free service period. Deferred revenue was primarily comprised of deferred revenue related to service contracts for the periods presented.

Because the Company has neither VSOE nor TPE for its systems, the allocation of revenue is based on BESP for the systems sold. The objective of BESP is to determine the price at which the Company would transact a sale, had the product been sold on a stand-alone basis. The Company determines BESP for its systems by considering multiple factors, including, but not limited to, features and functionality of the system, geographies, type of customer, and market conditions. The Company regularly reviews BESP and maintains internal controls over establishing and updating these estimates.

### Research and Development Costs

Research and development expenses primarily consist of engineering, product development and regulatory expenses, incurred in the design, development, testing and enhancement of our products and legal services associated with our efforts to obtain and maintain broad protection for the intellectual property related to our products. Research and development costs are expensed as incurred.

### Stock-Based Compensation

The Company follows ASC 718 ("Stock Compensation") and ASC 505-50 ("Equity-Based Payments to Non-employees"), which provide guidance in accounting for share-based awards exchanged for services rendered and requires companies to expense the estimated fair value of these awards over the requisite service period. For awards granted to non-employees, the Company determines the fair value of the stock-based compensation awards granted as either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. If the fair value of the equity instruments issued is used, it is measured using the stock price and other measurement assumptions as of the earlier of either (1) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached, or (2) the date at which the counterparty's performance is complete.

The Company recognizes compensation expense for stock-based awards based on estimated fair values on the date of grant for awards granted to employees. The Company uses the Black-Scholes-Merton option pricing model to determine the fair value of stock options. The fair value of restricted stock units is determined by the market price of the Company's common stock on the date of grant. The expense associated with stock-based compensation is recognized on a straight-line basis over the requisite service period of each award.

The Company records as expense the fair value of stock-based compensation awards, including stock options and restricted stock units. Compensation expense for stock-based compensation was approximately \$3,858,000 and \$2,388,000 for the nine months ended September 30, 2016 and 2015, respectively.

### Income Taxes

The Company accounts for income taxes using the asset and liability method, which requires the recognition of deferred tax assets or liabilities for the temporary differences between financial reporting and tax basis of the Company's assets and liabilities, and for tax carryforwards at enacted statutory rates in effect for the years in which the asset or liability is expected to be realized. The effect on deferred taxes of a change in tax rates is recognized in income during the period that includes the enactment date. In addition, valuation allowances are established when necessary to reduce deferred tax assets and liabilities to the amounts expected to be realized.

## 2. Summary of Significant Accounting Policies (Continued)

### Comprehensive Loss

Comprehensive loss is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources.

### Segments

The Company operates in one business segment—the research, development and sale of medical device robotics to improve minimally invasive surgery. The Company’s chief operating decision maker (determined to be the Chief Executive Officer) does not manage any part of the Company separately, and the allocation of resources and assessment of performance are based on the Company’s consolidated operating results. Approximately 53% of the Company’s total consolidated assets are located within the U.S. as of September 30, 2016. The remaining assets are mostly located in Europe and are primarily related to the Company’s facility in Italy, and include goodwill, intellectual property, in-process research and development, other current assets and inventory of \$93.3 million at September 30, 2016, associated with the Senhance Acquisition in September 2015. Total assets outside of the U.S. excluding goodwill amounted to 37% of total consolidated assets at September 30, 2016.

### Impact of Recently Issued Accounting Standards

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230)” which addresses changes to reduce the presentation diversity of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of certain debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, and distributions received from equity method investees. The guidance becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. An entity that elects early adoption must adopt all of the amendments in the same period. The new standard will be applied retrospectively, but may be applied prospectively if retrospective application would be impracticable. The Company is currently evaluating the new guidance and has not determined the impact this standard may have on its consolidated statement of cash flows.

In March 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-09, Compensation – Stock Compensation (Topic 718) – Improvements to Employee Share-Based Payment Accounting. Under ASU 2016-09, the tax effects of stock compensation will be recognized as income tax expense or benefit in the income statement and the tax effects of exercised or vested awards will be treated as discrete items in the reporting period in which they occur. Along with other income tax cash flows, excess tax benefits will be classified as operating activities, and cash paid by an employer when directly withholding shares for tax withholding purposes will be classified as financing activities. Entities may make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. The threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. For public companies, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted, however, an entity that elects early adoption must adopt all amendments under the new standard in the same period. The Company is currently evaluating the impact of the amended guidance on our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases*. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. We are currently evaluating the impact of our pending adoption of the new standard on our consolidated financial statements.

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). The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. In August 2015, the FASB issued an update to defer the effective date of this update by one year. The updated standard becomes effective for the Company in the first quarter of fiscal year 2018, but allows the Company to adopt the standard one year earlier if it so chooses. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on its Consolidated Financial Statements and related disclosures.

## 2. Summary of Significant Accounting Policies (Continued)

Except as noted above, there have been no significant changes to our assessment of the impact of recently issued accounting standards included in Note 2 of Notes to Consolidated Financial Statements in our Fiscal 2015 Form 10-K.

### Reclassifications

As a result of a recent acquisition, certain financial statement captions have been added and we have reclassified certain prior-period amounts on our consolidated statement of operations and comprehensive loss to conform to the presentation for the current period. Such reclassifications have no effect on previously reported total assets, liabilities, stockholders' equity or net loss.

### 3. Acquisition of Senhance Surgical Robotic System

On September 21, 2015, the Company completed the strategic acquisition, through its wholly owned subsidiary TransEnterix International, from SOFAR, of all of the assets, employees and contracts related to the advanced robotic system for minimally invasive laparoscopic surgery now known as the Senhance System and changed the name of the acquired company from Vulcanos S.r.l. to TransEnterix Italia S.r.l.

Under the terms of the Purchase Agreement, the consideration consisted of the issuance of 15,543,413 shares of the Company's common stock (the "Securities Consideration") and approximately \$25.0 million U.S. Dollars and €27.5 million Euro in cash consideration (the "Cash Consideration"). The Securities Consideration was issued in full at the closing of the Senhance Acquisition; the Cash Consideration was or will be paid in four tranches, as follows:

- (1) \$25.0 million of the Cash Consideration was paid at closing;
- (2) The second tranche of the Cash Consideration (the "Second Tranche") of €10.0 million shall be payable after the achievement of both of the following milestones (i) the earlier of approval from the FDA for the Senhance System or December 31, 2016, and (ii) the Company having cash on hand of at least \$50.0 million, or successfully completing a financing, raising at least \$50.0 million in gross proceeds; with payment of simple interest at a rate of 9.0% per annum between the achievement of the first milestone event and the payment date;
- (3) The third tranche of the Cash Consideration (the "Third Tranche") of €15.0 million shall be payable upon achievement of trailing revenues from sales or services contracts of the Senhance System of at least €25.0 million over a calendar quarter; and
- (4) The fourth tranche of the Cash Consideration of €2.5 million shall be payable by December 31, 2016 as reimbursement for certain debt payments made by SOFAR under an existing SOFAR loan agreement.

The Third Tranche will be payable even if the Second Tranche is not then payable. In addition, the Second Tranche and Third Tranche payments will be accelerated in the event that (i) the Company or TransEnterix International is acquired, (ii) the Company significantly reduces or suspends selling efforts of the Senhance System, or (iii) the Company acquires a business that offers alternative products that are directly competitive with the Senhance System.

Under the Purchase Agreement, 10% of the Securities Consideration was being held in escrow to support SOFAR's representations and warranties under the Purchase Agreement. In accordance with a related escrow agreement, the escrowed shares were released in September 2016. The Company, a subsidiary and SOFAR also entered into a Security Agreement, which provides that 10% of the membership interests of TransEnterix Italia have a lien placed thereon by and in favor of SOFAR to support the Company's representations and warranties under the Purchase Agreement. The security interest period is twenty-four months after the closing of the Senhance Acquisition.

The Purchase Agreement contains customary representations and warranties of the parties and the parties have customary indemnification obligations, which are subject to certain limitations described further in the Purchase Agreement.

In connection with the Senhance Acquisition, the Company also entered into a Registration Rights Agreement, dated as of September 21, 2015, with SOFAR, pursuant to which the Company agreed to register the Securities Consideration shares for resale following the end of the lock-up periods described below. The resale registration statement has been filed and is effective, pending lapse of the lock-up restrictions as described below.

### 3. Acquisition of Senhance Surgical Robotic System (Continued)

In connection with the Senhance Acquisition, SOFAR entered into a Lock-Up Agreement with the Company pursuant to which SOFAR agreed, subject to certain exceptions, not to sell, transfer or otherwise convey any of the Securities Consideration for one year following the Closing Date. On September 21, 2016, fifty percent of the Securities Consideration was released from the lock-up restrictions and is eligible to be resold under the effective resale registration statement. With respect to the remaining fifty percent of the Securities Consideration, the Lock-up Agreement provides that an additional twenty-five percent of the Securities Consideration remains locked-up until the eighteen-month anniversary of the Closing Date, and the remaining twenty-five percent of the Securities Consideration remains locked-up until the two-year anniversary of the Closing Date. The restrictions on transfer contained in the Lock-up Agreement cease to apply to all of the Securities Consideration following the second anniversary of the Closing Date, or earlier upon certain other conditions.

The Senhance Acquisition was accounted for as a business combination utilizing the methodology prescribed in ASC 805. The purchase price for the Senhance Acquisition has been allocated to the assets acquired and liabilities assumed based on their estimated fair values.

The Senhance Acquisition-date fair value of the consideration is as follows (in thousands, except for per share amounts):

|                          |                  |
|--------------------------|------------------|
| Common shares issued     | 15,543           |
| Closing price per share  | \$ 2.81          |
|                          | <u>\$ 43,677</u> |
| Cash consideration       | 25,000           |
| Contingent consideration | 23,900           |
| Total consideration      | <u>\$ 92,577</u> |

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on September 21, 2015, the date of acquisition (in thousands):

|  |                   |
|--|-------------------|
| Accounts receivable                    | \$ 78             |
| Inventories                            | 2,800             |
| Current deferred tax asset             | 526               |
| Other current assets                   | 4,180             |
| Property and equipment                 | 1,384             |
| Intellectual property                  | 48,500            |
| In-process research and development    | 17,100            |
| Goodwill                               | 38,348            |
| Total assets acquired                  | <u>\$ 112,916</u> |
| Accounts payable and other liabilities | 1,915             |
| Long-term deferred tax liabilities     | 18,424            |
| Net assets acquired                    | <u>\$ 92,577</u>  |

The Company allocated \$48.5 million of the purchase price to identifiable intangible assets of intellectual property that met the separability and contractual legal criterion of ASC 805. The intellectual property is being amortized using the straight-line method over 7 years.

IPR&D is principally the estimated fair value of the Senhance System technology which had not reached commercial technological feasibility nor had alternative future use at the time of the acquisition and therefore the Company considered IPR&D, with assigned values to be allocated among the various IPR&D assets acquired.

Goodwill is calculated as the difference between the acquisition-date fair value of the consideration transferred and the fair values of the assets acquired and liabilities assumed. The goodwill resulting from this acquisition arises largely from synergies expected from combining the operations of TransEnterix Italia with the Company's existing operations. The goodwill is not deductible for income tax purposes.



### 3. Acquisition of Senhance Surgical Robotic System (Continued)

All legal, consulting and other costs related to the acquisition, aggregating approximately \$4.2 million, have been expensed as incurred and are included in operating expenses in the Company's consolidated statement of operations and comprehensive loss for the year ended December 31, 2015. The results of operations for TransEnterix Italia are included in the Company's consolidated statements of operations and comprehensive loss for the period from the September 21, 2015 acquisition date.

### 4. Cash, Cash Equivalents and Restricted Cash

Cash, cash equivalents and restricted cash consist of the following:

|                                 | September 30,<br>2016 | December 31,<br>2015 |
|---------------------------------|-----------------------|----------------------|
|                                 | (In thousands)        |                      |
|                                 | (unaudited)           |                      |
| Cash                            | \$ 2,366              | \$ 1,666             |
| Money market                    | 40,152                | 36,783               |
| Total cash and cash equivalents | <u>\$ 42,518</u>      | <u>\$ 38,449</u>     |
| Restricted cash                 | \$ 10,353             | \$ —                 |
| Total                           | <u>\$ 52,871</u>      | <u>\$ 38,449</u>     |

### 5. Fair Value

The Company held certain assets and liabilities that are required to be measured at fair value on a recurring basis. These assets and liabilities include available for sale securities classified as cash and cash equivalents, restricted cash and contingent consideration. ASC 820-10 ("Fair Value Measurement Disclosure") requires the valuation using a three-tiered approach, which requires that fair value measurements be classified and disclosed in one of three tiers. These tiers are: Level 1, defined as quoted prices in active markets for identical assets or liabilities; Level 2, defined as valuations based on observable inputs other than those included in Level 1, such as quoted prices for similar assets and liabilities in active markets, or other inputs that are observable or can be corroborated by observable input data; and Level 3, defined as valuations based on unobservable inputs reflecting the Company's own assumptions, consistent with reasonably available assumptions made by other market participants.

For assets and liabilities recorded at fair value, it is the Company's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy. Fair value measurements for assets and liabilities where there exists limited or no observable market data and therefore, are based primarily upon estimates, are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures.

As prescribed by U.S. GAAP, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. An adjustment to the pricing method used within either Level 1 or Level 2 inputs could generate a fair value measurement that effectively falls in a lower level in the hierarchy.

The determination of where an asset or liability falls in the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures and based on various factors, it is possible that an asset or liability may be classified differently from period to period. However, the Company expects changes in classifications between levels will be rare.

The carrying values of accounts receivable, inventories, interest receivable, accounts payable, and certain accrued expenses at September 30, 2016 and December 31, 2015, approximate their fair values due to the short-term nature of these items. The Company's notes payable balance also approximates fair value as of September 30, 2016 and December 31, 2015, as they were modified in the third quarter of 2015.

## 5. Fair Value (Continued)

The following are the major categories of assets measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

| Description                              | September 30, 2016   |   |   | Total     |
|--|--|---|---|-----------|
|  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |           |
| (In thousands)<br>(unaudited)            |  |   |   |           |
| Assets measured at fair value            |  |   |   |           |
| Cash and cash equivalents                | \$ 42,518  | \$ —  | \$ —                                      | \$ 42,518 |
| Restricted cash                          | 10,353   | —   | —   | 10,353    |
| Total Assets measured at fair value      | \$ 52,871  | \$ —  | \$ —                                      | \$ 52,871 |
| Liabilities measured at fair value       |  |   |   |           |
| Contingent consideration                 | \$ —   | \$ —  | \$ 25,200                                 | \$ 25,200 |
| Total liabilities measured at fair value | \$ —   | \$ —  | \$ 25,200                                 | \$ 25,200 |
| December 31, 2015                        |  |   |   |           |
| (In thousands)                           |  |   |   |           |
| Description                              | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total     |
| Assets measured at fair value            |  |   |   |           |
| Cash and cash equivalents                | \$ 38,449  | \$ —  | \$ —                                      | \$ 38,449 |
| Total Assets measured at fair value      | \$ 38,449  | \$ —  | \$ —                                      | \$ 38,449 |
| Liabilities measured at fair value       |  |   |   |           |
| Contingent consideration                 | \$ —   | \$ —  | \$ 23,500                                 | \$ 23,500 |
| Total liabilities measured at fair value | \$ —   | \$ —  | \$ 23,500                                 | \$ 23,500 |

The Company's financial liabilities consisted of contingent consideration potentially payable to SOFAR related to the Senhance Acquisition in September 2015 (Note 3). This liability is reported as Level 3 as estimated fair value of the contingent consideration related to the acquisition requires significant management judgment or estimation and is calculated using the income approach, using various revenue and cost assumptions and applying a probability to each outcome. The change in fair value of the contingent consideration of \$1,700,000 for the nine months ended September 30, 2016 was primarily due to the effect of the passage of time on the fair value measurement and the impact of foreign currency exchange rates. Adjustments associated with the change in fair value of contingent consideration are included in the Company's consolidated statements of operations and comprehensive loss.

The following table presents quantitative information about the inputs and valuation methodologies used for the Company's fair value measurements classified in Level 3 as of September 21, 2015, December 31, 2015, and September 30, 2016:

|                          | Valuation Methodology                | Significant Unobservable Input | Weighted Average (range, if applicable) |
|--------------------------|--------------------------------------|--------------------------------|---|
| Contingent consideration | Probability weighted income approach | Milestone dates                | 2016 to 2017                            |
|                          |                                      | Discount rate                  | 7.5% to 9.0%                            |
|                          |                                      | Probability of occurrence      | 100%                                    |

## 5. Fair Value (Continued)

The following table summarizes the change in fair value, as determined by Level 3 inputs, for all assets and liabilities using unobservable Level 3 inputs for the nine months ended September 30, 2016:

|                               | <b>Fair Value<br/>Measurement at<br/>Reporting Date<br/>(Level 3)</b><br>(In thousands)<br>(unaudited) |
|-------------------------------|--|
| Balance at December 31, 2015  | \$ 23,500  |
| Change in fair value          | 1,700  |
| Balance at September 30, 2016 | <u>\$ 25,200</u>   |
| Current portion               | 11,325   |
| Long-term portion             | 13,875   |
| Balance at September 30, 2016 | <u>\$ 25,200</u>   |

## 6. Accounts Receivable, Net

The following table presents the components of accounts receivable:

|                                      | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------------------------|-------------------------------|------------------------------|
|                                      | (In thousands)<br>(unaudited) |                              |
| Gross accounts receivable            | \$ 968                        | \$ 76                        |
| Allowance for uncollectible accounts | (78)                          | —                            |
| Total accounts receivable, net       | <u>\$ 890</u>                 | <u>\$ 76</u>                 |
| Short-term portion                   | \$ 616                        | \$ 76                        |
| Long-term portion                    | 274                           | —                            |
| Total accounts receivable            | <u>\$ 890</u>                 | <u>\$ 76</u>                 |

## 7. Inventories

The components of inventories are as follows:

|                    | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------|-------------------------------|------------------------------|
|                    | (In thousands)<br>(unaudited) |                              |
| Finished goods     | \$ 2,250                      | \$ 2,704                     |
| Raw materials      | —                             | 1,928                        |
| Total inventories  | <u>\$ 2,250</u>               | <u>\$ 4,632</u>              |
| Short-term portion | \$ 2,250                      | \$ 3,923                     |
| Long-term portion  | —                             | 709                          |
| Total inventories  | <u>\$ 2,250</u>               | <u>\$ 4,632</u>              |

As disclosed in Note 14, the Company executed a restructuring plan in May 2016 and wrote down inventory related to the SurgiBot System. The write down of inventory of \$2.6 million is included in the accompanying consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2016. There were no such write-downs for the nine month periods ended September 30, 2015.

## 8. Other Current Assets

The following table presents the components of other current assets:

|                     | September 30,<br>2016 | December 31,<br>2015 |
|---------------------|-----------------------|----------------------|
|                     | (In thousands)        |                      |
|                     | (unaudited)           |                      |
| Advances to vendors | \$ 5,714              | \$ 5,403             |
| Prepaid expenses    | 2,060                 | 750                  |
| Other receivables   | 375                   | 536                  |
| Total               | <u>\$ 8,149</u>       | <u>\$ 6,689</u>      |

## 9. Property and Equipment

Property and equipment consisted of the following:

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
|   | (In thousands)        |                      |
|   | (unaudited)           |                      |
| Machinery and manufacturing equipment     | \$ 6,357              | \$ 5,846             |
| Computer equipment                        | 2,052                 | 1,875                |
| Furniture                                 | 448                   | 374                  |
| Leasehold improvements                    | 1,898                 | 1,700                |
| Total property and equipment              | 10,755                | 9,795                |
| Accumulated depreciation and amortization | (6,141)               | (5,387)              |
| Property and equipment, net               | <u>\$ 4,614</u>       | <u>\$ 4,408</u>      |

As disclosed in Note 14, the Company executed a restructuring plan in May 2016 and disposed of certain long-lived assets, primarily equipment and fixtures related to the SurgiBot System. The disposal of long-lived assets of \$1.0 million is included as a component of restructuring and other charges in the accompanying consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2016. There were no such disposals for the nine months ended September 30, 2015.

Depreciation expense was \$1,498,000 and \$802,000 for the nine months ended September 30, 2016 and 2015, respectively.

## 10. Goodwill, In-Process Research and Development and Intellectual Property

### Goodwill

Goodwill of \$93.8 million was recorded in connection with the Merger, as described in Note 1, and goodwill of \$38.3 million was recorded in connection with the Senhance Acquisition, as described in Note 3. The carrying value of goodwill and the change in the balance for the nine months ended September 30, 2016 is as follows:

|                                     | Goodwill<br>(In thousands)<br>(unaudited) |
|-------------------------------------|---|
| Balance at December 31, 2015        | \$ 130,869                                |
| Foreign currency translation impact | 863                                       |
| Impairment loss                     | (61,784)                                  |
| Balance at September 30, 2016       | <u>\$ 69,948</u>                          |

## 10. Goodwill, In-Process Research and Development and Intellectual Property (Continued)

The Company performs an annual impairment test of goodwill at December 31, or more frequently if events or changes in circumstances indicates that the carrying value of the Company's one reporting unit may not be recoverable. During the second quarter of 2016, the FDA notified the Company that the SurgiBot System did not meet the criteria for substantial equivalency, negatively impacting the Company's market capitalization, and warranting an interim two-step quantitative impairment test. Goodwill is tested for impairment using a two-step approach. In the first step, the fair value of the reporting unit is determined and compared to the reporting unit's carrying value, including goodwill. If the fair value of the reporting unit is less than its carrying value, the second step of the goodwill impairment test is performed to measure the amount of impairment, if any. In the second step, the fair value of the reporting unit is allocated to the assets and liabilities of the reporting unit as if it had been acquired in a business combination and the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared to the actual carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized for the difference.

The Company determined the fair value of the reporting unit using a discounted cash flow analysis derived from the Company's long-term plans. The fair value of the reporting unit was corroborated using market prices for TransEnterix, Inc. The inputs used to determine the fair values were classified as Level 3 in the fair value hierarchy. Based on the impairment test, the Company recorded goodwill impairment of \$61.8 million during the second quarter of 2016. No impairment was recorded as of December 31, 2015.

### *In-Process Research and Development*

As described in Note 3, on September 21, 2015, the Company acquired all of the assets related to the Senhance System and recorded \$17.1 million of IPR&D. The estimated fair value of the IPR&D was determined using a probability-weighted income approach, which discounts expected future cash flows to present value. The projected cash flows were based on certain key assumptions, including estimates of future revenue and expenses, taking into account the stage of development of the technology at the acquisition date and the time and resources needed to complete development. The Company used a discount rate of 45% and cash flows that have been probability adjusted to reflect the risks of product commercialization, which the Company believes are appropriate and representative of market participant assumptions.

The carrying value of the Company's IPR&D assets and the change in the balance for the nine months ended September 30, 2016 is as follows:

|                                     | <b>In-Process<br/>Research and<br/>Development</b><br><i>(In thousands)</i><br><u>(unaudited)</u> |
|-------------------------------------|---|
| Balance at December 31, 2015        | \$ 16,511   |
| Foreign currency translation impact | 461   |
| Balance at September 30, 2016       | <u>\$ 16,972</u>  |

### *Intellectual Property*

In 2009, the Company purchased certain patents from an affiliated company for \$5.0 million in cash and concurrently terminated a license agreement related to the patents. The patent expiration dates begin in 2027. In addition, as described in Note 3, on September 21, 2015, the Company acquired all of the developed technology related to the Senhance System and recorded \$48.5 million of intellectual property. The estimated fair value of the intellectual property was determined using a probability-weighted income approach, which discounts expected future cash flows to present value. The projected cash flows were based on certain key assumptions, including estimates of future revenue and expenses, taking into account the stage of development of the technology at the acquisition date and the time and resources needed to complete development. The Company used a discount rate of 45% and cash flows that have been probability adjusted to reflect the risks of product commercialization, which the Company believes are appropriate and representative of market participant assumptions.

As disclosed in Note 14, the Company executed a restructuring plan in May 2016 and wrote-off certain intellectual property consisting of patents related to the SurgiBot System. The write-off of intellectual property of \$1.6 million is included as a component of restructuring and other charges in the accompanying consolidated statements of operations and comprehensive losses for the nine months ended September 30, 2016. There were no such write offs for the nine months ended September 30, 2015.

## 10. Goodwill, In-Process Research and Development and Intellectual Property (Continued)

The components of gross intellectual property, accumulated amortization, and net intellectual property as of September 30, 2016 and December 31, 2015 are as follows:

|                             | September 30, 2016    |                          |                                     |                  |                     | December 31, 2015     |                          |                                     |           |                     |
|-----------------------------|-----------------------|--------------------------|-------------------------------------|------------------|---------------------|-----------------------|--------------------------|-------------------------------------|-----------|---------------------|
|                             | (In thousands)        |                          |                                     |                  |                     | (In thousands)        |                          |                                     |           |                     |
|                             | Gross Carrying Amount | Accumulated Amortization | Foreign currency translation impact | Write-off        | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Foreign currency translation impact | Write-off | Net Carrying Amount |
| Patents                     | \$ 5,000              | \$ (3,438)               | \$ —                                | \$(1,562)        | \$ —                | \$ 5,000              | \$ (3,259)               | \$ —                                | —         | \$ 1,741            |
| Developed technology        | 48,500                | (6,803)                  | (437)                               | —                | 41,260              | 48,500                | (1,672)                  | (1,671)                             | —         | 45,157              |
| Total intellectual property | <u>\$53,500</u>       | <u>\$ (10,241)</u>       | <u>\$ (437)</u>                     | <u>\$(1,562)</u> | <u>\$41,260</u>     | <u>\$53,500</u>       | <u>\$ (4,931)</u>        | <u>\$ (1,671)</u>                   | <u>—</u>  | <u>\$46,898</u>     |

## 11. Income Taxes

Income taxes have been accounted for using the liability method in accordance with ASC 740 "Income Taxes". The Company computes its interim provision for income taxes by applying the estimated annual effective tax rate method. The Company estimates an annual effective tax rate of 5.1% for the year ending December 31, 2016. This rate does not include the impact of any discrete items. The Company incurred losses for the three and nine month periods ended September 30, 2016 and is forecasting additional losses through the year, resulting in an estimated net loss for both financial statement and tax purposes for the year ending December 31, 2016. Due to the Company's history of losses, there is not sufficient evidence to record a net deferred tax asset associated with the U.S. operations and accordingly a full valuation allowance has been recorded related to the net deferred tax asset in that jurisdiction. Deferred tax assets and liabilities related to the TransEnterix Italia subsidiary have been recorded as a component of purchase accounting as of the acquisition date. The deferred tax benefit during the nine months ended September 30, 2016 of approximately \$4.7 million includes an immaterial adjustment of approximately \$1.7 million to the deferred tax liability of TransEnterix Italia which relates to a change in the Italian income tax rate in December 2015.

There is no net deferred tax asset recorded in relation to TransEnterix Italia and accordingly no valuation allowance has been recorded in that jurisdiction.

The Company's effective tax rate for each of the nine month periods ended September 30, 2016 and 2015 was 4.3% and 0%, respectively. The effective tax rate for September 30, 2016 includes the tax effect of the Company's goodwill impairment charge, which is being treated as a discrete item for the quarter ending June 30, 2016. At September 30, 2016, the Company had no unrecognized tax benefits that would affect the Company's effective tax rate.

## 12. Accrued Expenses

The following table presents the components of accrued expenses:

|                                | September 30, 2016 | December 31, 2015 |
|--------------------------------|--------------------|-------------------|
|                                | (In thousands)     |                   |
|                                | (unaudited)        |                   |
| Taxes and other assessments    | \$ 3,220           | \$ 3,112          |
| Compensation and benefits      | 1,718              | 2,492             |
| Interest and final payment fee | 881                | 411               |
| Deferred rent                  | 301                | 278               |
| Consulting and other vendors   | 776                | 553               |
| Legal and professional fees    | 226                | 268               |
| Restructuring charges          | 49                 | —                 |
| Other                          | 75                 | 281               |
| Total                          | <u>\$ 7,246</u>    | <u>\$ 7,395</u>   |

### 13. Notes Payable

On January 17, 2012, TransEnterix Surgical entered into a loan and security agreement with Silicon Valley Bank and Oxford Finance LLC (the "Lenders"). The terms of the Original Loan Agreement provided for two term loans in aggregate of \$10,000,000 comprised of a \$4,000,000 term loan and a \$6,000,000 term loan. In connection with the Merger, the Company assumed and became the borrower under TransEnterix Surgical's Original Loan Agreement, and agreed to amendments to the Original Loan Agreement, dated as of September 3, 2013 and October 31, 2013, respectively. The Original Loan Agreement had a maturity date of January 1, 2016 and a fixed interest rate of 8.75% per annum. As of September 26, 2014, the outstanding principal amount of the Original Loan Agreement was \$5,604,000.

On September 26, 2014, the Company entered into the Amended and Restated Loan Agreement with the Lenders. Under the Amended and Restated Loan Agreement, the Lenders agreed to make certain term loans (the "Amended and Restated Term Loans") in an aggregate principal amount of up to \$25,000,000. The first tranche of the Amended and Restated Term Loans increased the Company's borrowings at September 26, 2014 from \$5,604,000 to \$10,000,000. The Amended and Restated Term Loans allowed for interest-only payment at 7.5% per annum through October 31, 2015 and a maturity date of April 1, 2018.

On August 14, 2015, the Company entered into the First Amendment to the Amended and Restated Loan Agreement (the "First Amendment") with the Lenders. The first tranche of the First Amendment increased the Company's borrowings at August 14, 2015 from \$10,000,000 to \$20,000,000. The First Amendment allowed for interest-only payments at 7.5% per annum through April 30, 2016 and a maturity date of October 1, 2018.

On September 18, 2015, in connection with entry into the Purchase Agreement with SOFAR S.p.A. (see Note 3 for a description of the related transactions), the Company and the Lenders entered into the Consent and Second Amendment to Amended and Restated Loan Agreement (the "Second Amendment"). The Second Amendment modified the period in which the Company can make interest-only payments at 7.5% per annum on the term loans until January 31, 2016. The Second Amendment has a maturity date of July 1, 2018.

In connection with the entry into the loan agreements, the Company became obligated to pay final payment and facility fees. The final payment fee obligation paid under the Original Loan Agreement at 3.33% was \$333,000 and the facility fee payment was \$75,000. The final payment fee obligation paid under the Amended and Restated Loan Agreement at 5.45% was \$165,920 and the facility fee was \$90,000. The facility fee paid under the First Amendment was \$90,000. The final payment fee obligation payable under the Second Amendment is 6.5% of the original principal amount of each term loan without the interest only extension and 8.0% with both interest-only extensions.

In addition, in connection with the borrowings, the Company issued warrants to the Lenders to purchase shares of the Company's common stock amounting to 279,588 warrants under the Original Loan Agreement, 38,324 warrants under the Amended and Restated Loan Agreement and 112,903 under the First Amendment. Additional warrants will be issued if additional tranche term loans are made. The warrants expire seven years from their respective issue date.

The Amended and Restated Loan Agreement, as amended, is secured by a security interest in all assets of the Company and its current and future U.S. subsidiaries, including a security interest in intellectual property proceeds, but excluding a current security interest in intellectual property. The Amended and Restated Loan Agreement contains customary representations (tested on a continual basis) and covenants that, subject to exceptions, restrict the Company's ability to do the following things: declare dividends or redeem or repurchase equity interests; incur additional liens; make loans and investments; incur additional indebtedness; engage in mergers, acquisitions, and asset sales; transact with affiliates; undergo a change in control; add or change business locations; and engage in businesses that are not related to its existing business.

### 13. Notes Payable (Continued)

Further, under the Second Amendment, the Lenders consented to the formation of TransEnterix International, the entry of the Company into the Purchase Agreement and other transaction documents, and the name change of TransEnterix Italia. The Company agreed to pledge 100% of the common stock of TransEnterix International as additional security for the borrowings under the Amended and Restated Loan Agreement, as amended. The Second Amendment added a provision permitting the Company to transfer designated amounts to TransEnterix Italia during the term of the Amended and Restated Loan Agreement. This provision for the transfer of designated amount was amended on November 13, 2015 with the Third Amendment to the Amended and Restated Loan Agreement. On April 19, 2016, the Company and its U.S. subsidiaries entered into the Consent and Fourth Amendment to the Loan Agreement (the "Fourth Amendment") pursuant to which TransEnterix International, joined the Loan Agreement and the existing promissory notes as a co-borrower thereunder and pledged, as collateral for the obligations under the Loan Agreement, substantially all of its non-intellectual property assets, including up to 65% of the equity interests owned by TransEnterix International in TransEnterix Europe S.Á.R.L, a wholly owned subsidiary of TransEnterix International. On September 7, 2016, the Company and its U.S. subsidiaries entered into the Fifth Amendment to the Loan Agreement (the "Fifth Amendment"). The Fifth Amendment provides more flexibility to the Company with respect to its intercompany activities with its foreign subsidiaries and adds an affirmative covenant requiring the Company to maintain a \$10.0 million cash balance in accounts held with the Lender. Cash amounts related to this requirement are included in restricted cash on the consolidated balance sheet.

In accordance with ASC 470-50 *Debt – Modifications and Extinguishments*, it was determined that the debt refinancing on September 26, 2014, was considered to be a debt modification. Accordingly, the Company recorded approximately \$129,000 of debt discount, consisting of the \$75,000 facility fee and the relative fair value of warrants on the issue date of \$54,000. Additionally, approximately \$30,000 of legal fees were recorded as a result of the transaction. The debt discount and deferred financing costs will be amortized over the life of the new debt agreement using the effective interest method into interest expense, net.

In accordance with ASC 470-50 *Debt – Modifications and Extinguishments*, it was determined that the debt refinancings on August 14, 2015, September 18, 2015, April 19, 2016 and September 7, 2016 were considered to be debt modifications. Additionally, during the third quarter of 2015, the Company adopted ASU No. 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs". ASU 2015-03 requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. The Company recorded a debt discount of approximately \$210,000 for these two amendments. Accordingly, the unamortized debt discount is presented as a reduction of the related debt liability in the Company's balance sheet. In accordance with ASU 2015-03, this adopted guidance was applied retrospectively. The debt discount will be amortized over the life of the new debt agreement using the effective interest method into interest expense, net.

In connection with the issuance of the notes payable and its amendments, TransEnterix Surgical incurred approximately \$371,000 in debt issuance costs paid to lenders and third parties and \$280,000 in debt issuance costs related to issuance of warrants to the lenders. The unamortized balance of \$143,000 as of September 30, 2016 will be amortized using the effective interest method.

### 14. Restructuring

On April 19, 2016, the FDA notified the Company that the SurgiBot System did not meet the criteria for substantial equivalence based on the data submitted in the 510(k) submission. As a result, the Company has reprioritized its efforts to focus on the commercialization of and regulatory clearance for the Senhance System. Consequently, in May 2016, the Company implemented a restructuring plan. Under the restructuring plan, the Company reduced headcount, discontinued efforts on the SurgiBot System, and cancelled certain contracts. The restructuring charges amounted to \$5.7 million, of which \$2.6 million was included as inventory write down related to restructuring and \$3.1 million was included as restructuring and other charges in the consolidated statements of operations and comprehensive loss, during the second quarter of 2016.

The restructuring and other charges of \$3.1 million included: (i) \$0.5 million to be paid in cash, of which \$0.4 million related to employee severance costs and \$0.1 million related to cancellation of certain contracts; and (ii) \$2.6 million for other non-cash charges, of which \$1.0 million related to the disposal of long-lived assets for the abandonment of certain equipment and tooling directly relating to the SurgiBot System and \$1.6 million related to the write-off of intellectual property for certain patents also relating to the SurgiBot System. The Company does not anticipate additional restructuring charges in 2016. The total future payments under the restructuring plan as of September 30, 2016 included in accrued expenses in the consolidated balance sheet as of September 30, 2016 are \$49,000.



## 15. Public Offerings of Common Stock

On February 20, 2015, the Company entered into a Controlled Equity Offering<sup>SM</sup> Sales Agreement (the “2015 Sales Agreement”) with Cantor Fitzgerald & Co. (“Cantor”), as sales agent, pursuant to which the Company sold through Cantor, from time to time, up to \$25.0 million in shares of common stock in an at-the-market offering. All sales of shares were made pursuant to an effective shelf registration statement on Form S-3 filed with the SEC. The Company pays Cantor a commission of approximately 3% of the aggregate gross proceeds received from all sales of common stock under the Sales Agreement. Sales under the 2015 Sales Agreement have been fully sold as of February 9, 2016, with cumulative shares of 7,724,488, gross proceeds of \$25.0 million and net proceeds of \$24.0 million.

On June 11, 2015, the Company sold 16,666,667 shares of common stock at a public offering price of \$3.00 per share for aggregate gross proceeds of \$50 million in an underwritten firm commitment public offering. Net proceeds after issuance costs were \$46.4 million. The closing of the public offering occurred on June 17, 2015. The Company granted the underwriters an option, exercisable for 30 days, to purchase up to an additional 2,500,000 shares of Common Stock.

On July 10, 2015, the underwriters exercised a portion of their option to acquire an additional 2,075,000 shares at the public offering price of \$3.00 per share for aggregate additional gross proceeds of \$6.2 million. Net proceeds after issuance costs were \$5.8 million. The purchase of the option shares closed on July 15, 2015. Total proceeds (including the option) were \$52.2 million, net of issuance costs of \$4.0 million. The common stock was offered and sold pursuant to the Shelf Registration Statement filed in November 2014 (the “November 2014 Shelf Registration Statement”), which was declared effective on December 19, 2014. The November 2014 Shelf Registration Statement allowed the Company to raise up to \$100.0 million through the sale of debt securities, common stock, preferred stock, warrants, or any combination thereof. On March 3, 2016, the Company filed an amendment to the November 2014 Shelf Registration Statement increasing the amount available from \$100.0 million to \$150.0 million.

On February 9, 2016, the Company entered into a Controlled Equity Offering<sup>SM</sup> Sales Agreement (the “2016 Sales Agreement”) with Cantor, as sales agent, pursuant to which the Company can sell through Cantor, from time to time, up to \$43.6 million in shares of common stock in an at-the-market offering. All sales of shares have been and will continue to be made pursuant to an effective shelf registration statement on Form S-3 filed with the SEC. The Company pays Cantor a commission of approximately 3% of the aggregate gross proceeds received from all sales of common stock under the 2016 Sales Agreement. Unless otherwise terminated earlier, the 2016 Sales Agreement continues until all shares available under the Sales Agreement have been sold.

The following table summarizes the total sales under the 2015 Sales Agreement and 2016 Sales Agreement for the periods indicated (in thousands, except per share amounts):

|                                   | 2015 Sales Agreement                 |                              | 2016 Sales Agreement                 |
|-----------------------------------|--------------------------------------|------------------------------|--------------------------------------|
|                                   | Nine Months Ended September 30, 2016 | Year Ended December 31, 2015 | Nine Months Ended September 30, 2016 |
| Total shares of common stock sold | 5,710.2                              | 2,014.3                      | 8,763.4                              |
| Average price per share           | \$ 3.23                              | \$ 3.25                      | \$ 4.70                              |
| Gross proceeds                    | \$ 18,454                            | \$ 6,546                     | \$ 41,156                            |
| Commissions earned by Cantor      | \$ 553                               | \$ 197                       | \$ 1,235                             |
| Other issuance costs              | \$ —                                 | \$ 259                       | \$ 185                               |

On April 14, 2014, the Company sold 12,500,000 shares of common stock at a public offering price of \$4.00 per share for aggregate gross proceeds of \$50.0 million in an underwritten firm commitment public offering. Certain of the Company’s existing stockholders that are affiliated with certain of the Company’s directors purchased \$10.0 million of common stock in the public offering. The closing of the public offering occurred on April 21, 2014. The Company granted the underwriters an option, exercisable for 30 days, to purchase up to an additional 1,875,000 shares of Common Stock to cover over-allotments. On April 30, 2014, the underwriters exercised a portion of their over-allotment option to acquire an additional 1,610,000 shares at the public offering price of \$4.00 per share for aggregate additional gross proceeds of \$6.4 million. The purchase of the over-allotment shares closed on May 5, 2014. Total proceeds were \$52.4 million, net of issuance costs of \$4.0 million. The common stock was offered and sold pursuant to the Shelf Registration Statement filed in January 2014 (the “January 2014 Shelf Registration Statement”), which was declared effective on April 2, 2014. The January 2014 Shelf Registration Statement allowed the Company to raise up to \$100.0 million through the sale of debt securities, common stock, preferred stock, warrants, or any combination thereof. As of September 30, 2016, the Company had \$71.2 million available for future financings under such shelf registration statements.

## 16. Basic and Diluted Net Loss per Share

Basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per common share is computed giving effect to all dilutive potential common shares that were outstanding during the period. Diluted potential common shares consist of incremental shares issuable upon exercise of stock options and warrants and conversion of preferred stock. In computing diluted net loss per share for the nine months ended September 30, 2016 and 2015, no adjustment has been made to the weighted average outstanding common shares as the assumed exercise of outstanding options and warrants and conversion of preferred stock would be anti-dilutive.

## 17. Related Person Transactions

Synergy Life Science Partners, L.P. and Synecor, LLC collectively owned approximately 5% and 6% of the Company's common stock at September 30, 2016 and 2015, respectively. A member of the Company's Board of Directors is managing partner of Synergy Life Science Partners, L.P. and an executive officer of Synecor, LLC. Various research and development services were purchased by the Company from Synecor LLC and its wholly owned subsidiary Synchrony Labs LLC pursuant to arms' length terms approved by the Audit Committee and totaled approximately \$5,000 and \$434,000 for the nine months ended September 30, 2016 and 2015, respectively.

On September 18, 2015, TransEnterix Italia entered into a six month service agreement for administrative expenses and rent with SOFAR, a shareholder that owned approximately 13.5% and 15.5% of the Company's common stock at September 30, 2016 and 2015, respectively. Expenses under this agreement were approximately \$162,000 and \$0 for the nine months ended September 30, 2016 and 2015, respectively.

## 18. Commitments and Contingencies

### *Contingent Consideration*

As discussed in Note 3, in September 2015, the Company completed the Senhance Acquisition using a combination of cash, stock and potential post-acquisition milestone payments. These milestone payments may be payable in the future, depending on the achievement of certain regulatory and commercial milestones. The maximum amount of the aggregate milestone payments could be €27.5 million. As of September 30, 2016, the fair value of the contingent consideration was \$25.2 million.

### *Legal Proceedings*

On June 2, 2016 a stockholder filed a putative class action complaint, *Ashok V. Bankley, individually and on behalf of all others similarly situated vs. TransEnterix, Inc., Todd M. Pope and Joseph P. Slattery*, in the United States District Court for the Eastern District of North Carolina (Case No. 5:16-cv-00313-D) (the "Initial Complaint"), against the Company and two of its executive officers on behalf of all persons who purchased or otherwise acquired the Company's common stock between February 10, 2016 and May 10, 2016. On August 4, 2016, the defendants filed a motion to dismiss the Initial Complaint for failure to state a claim under the securities laws. On August 30, 2016, the court appointed Randall Clark, Samir Patel, the Underhill Cemetery Association, and the North Underhill Cemetery Association as the lead plaintiffs in the Initial Complaint, and also provided the plaintiffs an opportunity to amend the Initial Complaint. On September 26, 2016, the lead plaintiffs filed an Amended Complaint. Among other things, the Amended Complaint asserts revised claims against the Company and Messrs. Pope and Slattery, and adds claims against certain current and former members of the Company's Board of Directors, and Cantor Fitzgerald & Co., the sales agent under the 2016 Sales Agreement, under which the Company offered and sold, through Cantor, shares of common stock in its 2016 ATM Offering. The Amended Complaint alleges that the defendants made false and misleading public statements related to the Company's SurgiBot System and its 510(k) application in violation of certain federal securities laws. The Amended Complaint seeks class certification of a class consisting of all persons who purchased or otherwise acquired the Company's common stock between February 10, 2016 and May 10, 2016, class certification of a subclass of persons who purchased or otherwise acquired the Company's common stock in connection with the 2016 ATM Offering between February 9, 2016 and April 19, 2016, unspecified monetary damages, costs, and attorneys' fees. On November 8, 2016, the defendants moved to dismiss the Amended Complaint.

On June 9, 2016, a different stockholder filed another putative class action complaint, *Thomas Ravey, individually and on behalf of all others similarly situated vs. TransEnterix, Inc., Todd M. Pope and Joseph P. Slattery*, in the United States District Court for the Middle District of North Carolina (Case No. 1:16-cv-599) (the "Ravey Action"). The Ravey Action asserted substantially similar claims against the same defendants and seeks substantially similar relief as the Initial Complaint. On August 4, 2016, the plaintiff in the Ravey Action voluntarily dismissed the Ravey Action.

## 18. Commitments and Contingencies (Continued)

On July 8, 2016, a stockholder filed a putative derivative complaint, *Otto Pikal v. Todd M. Pope, et al.*, in the General Court of Justice, Superior Court Division, Wake County, North Carolina (case number 16CV008930), on behalf of the Company against certain of our current officers and directors. The complaint alleges, among other things, that the defendants breached their fiduciary duties by disseminating false and misleading information to the Company's shareholders relating to the Company's SurgiBot System and its 510(k) application in violation of certain federal securities laws and by failing to ensure that the Company maintained adequate internal controls. The complaint seeks, among other things, unspecified monetary damages and an order directing the Company to take steps to improve its corporate governance and to protect the Company and its stockholders from future wrongdoing such as that alleged in the complaint. On September 29, 2016, the court entered an order staying the litigation pending resolution of the motion to dismiss the Amended Complaint in the *Bankley* Action.

On April 25, 2016, Intuitive Surgical, Inc. and its French subsidiary, Intuitive Surgical SAS (collectively, "Intuitive"), brought a request for unilateral measures of enquiry in front of the President of the Commercial Court of Toulon (France) (the "President") against two employees of TransEnterix International, Inc. alleging that the company, through these two employees, engaged in acts of unfair competition. On May 3, 2016, the President rendered an order granting Intuitive's request for unilateral measures of enquiry with respect to its allegations (the "Order"). On June 28, 2016, TransEnterix International filed a writ challenging the Order and requesting that it be withdrawn by the President. On September 7, 2016, the President rendered his decision on TransEnterix International's challenge (the "Ruling") and ruled in favor of TransEnterix International. Under the Ruling, the Intuitive unilateral measures of enquiry were declared to be unjustified and the Order was withdrawn. The President also declared that the Ruling was provisionally enforceable. Intuitive has filed an appeal against the Ruling (the "Appeal") with the Court of Appeal of Aix-en-Provence (France). No hearing date for the Appeal has yet been noticed. In addition, because Intuitive did not comply with the Ruling, TransEnterix International filed a dismissal request against the Appeal with the same Court of Appeal (the "Dismissal Request"). A hearing has been scheduled on January 3, 2017 with respect to the Dismissal Request.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes to our consolidated financial statements included in this report. The following discussion contains forward-looking statements. See cautionary note regarding "Forward-Looking Statements" at the beginning of this report.

### Overview

TransEnterix, Inc. (the "Company," "we" or "us") is a medical device company that is pioneering the use of robotics to improve minimally invasive surgery by addressing the clinical challenges associated with current laparoscopic and robotic options. We are focused on the commercialization and further development of our Senhance™ Surgical Robotic System (formerly known as the ALF-X® Surgical Robotic System) (the "Senhance System"), a multi-port robotic system that brings the advantages of robotic surgery to patients while enabling surgeons with innovative technology. The Senhance System has been granted a CE Mark in Europe for laparoscopic abdominal and pelvic surgery, as well as limited thoracic operations excluding cardiac and vascular surgery, but is not available for sale in the U.S. We have also developed the SurgiBot™ System (the "SurgiBot System"), a single-port, robotically enhanced laparoscopic surgical platform. The SurgiBot System is not available for sale in any market.

The Senhance System is a multi-port robotic surgery system which allows multiple robotic arms to control instruments and a camera. The system features advanced technology to enable surgeons with haptic feedback and the ability to move the camera via eye movement. The system replicates laparoscopic motion that is familiar to experienced surgeons, and integrates three-dimensional high definition ("3DHD") vision technology. The Senhance System also offers responsible economics to hospitals by offering robotic technology with reusable instruments thereby reducing additional costs per surgery when compared to other robotic solutions.

The SurgiBot System is designed to utilize flexible instruments through articulating channels controlled directly by the surgeon, with robotic assistance, while the surgeon remains patient-side within the sterile field. In June 2015, the Company submitted a 510(k) application to the FDA for the SurgiBot System. On April 19, 2016, the FDA notified the Company that the SurgiBot System did not meet the criteria for substantial equivalence based on the data and information submitted by TransEnterix in the 510(k) submission.

Our current strategy is to focus our resources on the commercialization of and regulatory clearance for the Senhance System. After recent interactions with the FDA, a new 510(k) application would need to be submitted in order to obtain clearance for the SurgiBot System. Based on this fact, we have evaluated the operational and financial feasibility of pursuing two 510(k) applications in parallel and have elected to primarily focus our near term efforts on the 510(k) submission for the Senhance System.

Consequently, in May 2016, the Company implemented a restructuring plan. The restructuring plan resulted in: 1) reducing the Company's workforce; 2) abandoning certain equipment; 3) cancelling certain contracts; 4) writing off inventory related to the SurgiBot System; and 5) writing off certain patents.

From our inception, we devoted a substantial percentage of our resources to research and development and start-up activities, consisting primarily of product design and development, clinical studies, manufacturing, recruiting qualified personnel and raising capital.

Since inception, we have been unprofitable. As of September 30, 2016 we had an accumulated deficit of \$288.9 million.

We expect to continue to invest in research and development and related clinical studies, and increase selling, general and administrative expenses as we grow. As a result, we will need to generate significant revenue in order to achieve profitability.

We operate in one business segment.

### Recent Events

#### Controlled Equity Offering

On February 9, 2016, we entered into a Controlled Equity Offering<sup>SM</sup> Sales Agreement (the "2016 Sales Agreement") with Cantor Fitzgerald & Co. ("Cantor") under which we can offer and sell, through Cantor, up to approximately \$43.6 million in shares of common stock in an at-the market offering (the "2016 ATM Offering"). On February 20, 2015, we had entered into a Controlled Equity Offering<sup>SM</sup> Sales Agreement (the "2015 Sales Agreement") with Cantor, as sales agent, pursuant to which we offered and sold, through Cantor, \$25.0 million in shares of common stock in an at-the-market offering from February 2015 through February 2016 (the "2015 ATM Offering"). All sales of shares were made pursuant to an effective shelf registration statement on Form S-3 filed with the Securities and Exchange Commission (the "SEC"). We pay Cantor a commission of approximately 3% of the aggregate gross proceeds received from all sales of common stock under the 2015 Sales Agreement and the 2016 Sales Agreement.

The following table summarizes the total sales under the 2015 Sales Agreement and 2016 Sales Agreement for the periods indicated (in thousands, except per share amounts):

|                                   | 2015 Sales Agreement                 |                              | 2016 Sales Agreement                 |
|-----------------------------------|--------------------------------------|------------------------------|--------------------------------------|
|                                   | Nine Months Ended September 30, 2016 | Year Ended December 31, 2015 | Nine Months Ended September 30, 2016 |
| Total shares of common stock sold | 5,710.2                              | 2,014.3                      | 8,763.4                              |
| Average price per share           | \$ 3.23                              | \$ 3.25                      | \$ 4.70                              |
| Gross proceeds                    | \$ 18,454                            | \$ 6,546                     | \$ 41,156                            |
| Commissions earned by Cantor      | \$ 553                               | \$ 197                       | \$ 1,235                             |
| Other issuance costs              | \$ —                                 | \$ 259                       | \$ 185                               |

### Public Offering

On June 11, 2015, we sold 16,666,667 shares of common stock at a public offering price of \$3.00 per share for aggregate gross proceeds of \$50.0 million in an underwritten firm commitment public offering. We granted the underwriters an option, exercisable for 30 days, to purchase up to an additional 2,500,000 shares of common stock to cover over-allotments. The common stock was offered and sold pursuant to our shelf registration statement on Form S-3 (File No. 333-199998) registering an aggregate of \$100.0 million of our designated securities. The closing of the public offering occurred on June 17, 2015. On July 10, 2015, the underwriters exercised a portion of their over-allotment option to acquire an additional 2,075,000 shares at the public offering price of \$3.00 per share for aggregate additional gross proceeds of \$6.2 million. The purchase of the over-allotment shares closed on July 15, 2015. Total proceeds were \$52.2 million, net of issuance costs of \$4.0 million.

### Senhance Acquisition and Related Transactions

#### Membership Interest Purchase Agreement

On September 21, 2015, the Company announced that it had entered into a Membership Interest Purchase Agreement, dated September 18, 2015 (the "Purchase Agreement") with SOFAR S.p.A., (the "Seller"), Vulcanos S.r.l., as the acquired company, and TransEnterix International, Inc., a wholly owned subsidiary of the Company (the "Buyer"). The closing of the transactions contemplated by the Purchase Agreement occurred on September 21, 2015 (the "Closing Date") pursuant to which the Buyer acquired all of the membership interests of the acquired company from the Seller, and changed the name of the acquired company to TransEnterix Italia S.r.l ("TransEnterix Italia"). On the Closing Date, pursuant to the Purchase Agreement, the Company completed the strategic acquisition from SOFAR S.p.A. of all of the assets, employees and contracts related to the advanced robotic system for minimally invasive laparoscopic surgery now known as the Senhance System (the "Senhance Acquisition").

Under the terms of the Purchase Agreement, the consideration consisted of the issuance of 15,543,413 shares of the Company's common stock (the "Securities Consideration") and approximately \$25,000,000 U.S. Dollars and 27,500,000 Euro in cash consideration (the "Cash Consideration"). The Securities Consideration was issued in full at closing of the acquisition; the Cash Consideration was or will be paid in four tranches, with US \$25,000,000 paid at closing and the remaining Cash Consideration of 27,500,000 Euro to be paid in three additional tranches based on achievement of negotiated milestones.

The issuance of the Securities Consideration was effected as a private placement of securities under Section 4(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"), and Regulation D promulgated thereunder.

The Purchase Agreement contains customary representations and warranties of the parties and the parties have customary indemnification obligations, which are subject to certain limitations described further in the Purchase Agreement.

#### Registration Rights and Lock-Up Agreements

In connection with the Senhance Acquisition, we also entered into a Registration Rights Agreement, dated as of September 21, 2015, with the Seller, pursuant to which we agreed to register the Securities Consideration shares for resale following the end of the lock-up periods described below. The resale Registration Statement has been filed and is effective, pending lapse of the lock-up restrictions described below.

In connection with the Senhance Acquisition, SOFAR entered into a Lock-Up Agreement with us pursuant to which SOFAR agreed, subject to certain exceptions, not to sell, transfer or otherwise convey any of the Securities Consideration for one year following the Closing Date. On September 21, 2016, fifty percent of the Securities Consideration was released from the lock-up restrictions and is

eligible to be resold under the effective resale registration statement. With respect to the remaining fifty percent of the Securities Consideration, the Lock-up Agreement provides that an additional twenty-five percent of the Securities Consideration remains locked-up until the eighteen-month anniversary of the Closing Date, and the remaining twenty-five percent of the Securities Consideration remains locked-up until the two-year anniversary of the Closing Date. The restrictions on transfer contained in the Lock-up Agreement cease to apply to all of the Securities Consideration following the second anniversary of the Closing Date, or earlier upon certain other conditions.

### ***Amendment to Loan Agreement***

In connection with entry into the Purchase Agreement, we sought the consent of Silicon Valley Bank (“SVB”), as a Lender, and Oxford Finance LLC (“Oxford”), as Lender and Collateral Agent under our existing Amended and Restated Loan and Security Agreement, dated as of September 26, 2014, as amended by the First Amendment, dated August 14, 2015 (collectively, the “Loan Agreement”), and entered into the Consent and Second Amendment to Amended and Restated Loan Agreement (the “Second Amendment”). Under the Second Amendment, the Lenders and Collateral Agent consented to the formation of the Buyer, the entry of the Company and Buyer entering into the Purchase Agreement and other transaction documents, and the name change of TransEnterix Italia. We agreed to pledge 100% of the common stock of the Buyer as additional security for the borrowings under the Loan Agreement. The Second Amendment added a provision permitting the Company to transfer designated amounts to TransEnterix Italia during the term of the Loan Agreement. Further, the Second Amendment modified the period in which we could make interest-only payments on the term loans until January 31, 2016. On April 19, 2016, the Company and its U.S. subsidiaries entered into the Consent and Fourth Amendment to the Loan Agreement (the “Fourth Amendment”) pursuant to which TransEnterix International, joined the Loan Agreement and the existing promissory notes as a co-borrower thereunder and pledged, as collateral for the obligations under the Loan Agreement, substantially all of its non-intellectual property assets, including up to 65% of the equity interests owned by TransEnterix International in TransEnterix Europe S.á.r.l., a wholly owned subsidiary of TransEnterix International. On September 7, 2016, the Company and its U.S. subsidiaries entered into the Fifth Amendment to the Loan Agreement (the “Fifth Amendment”). The Fifth Amendment provides more flexibility to the Company with respect to its intercompany activities with its foreign subsidiaries and adds an affirmative covenant requiring the Company to maintain a \$10.0 million cash balance in accounts held with the Lender

### **2013 Merger Transaction**

On September 3, 2013, TransEnterix Surgical, Inc., a Delaware corporation formerly known as TransEnterix, Inc. (“TransEnterix Surgical”), and SafeStitch Medical, Inc., a Delaware corporation (“SafeStitch”), consummated a merger transaction whereby TransEnterix Surgical merged with a merger subsidiary of SafeStitch, with TransEnterix Surgical as the surviving entity in the merger (the “Merger”). As a result of the Merger, TransEnterix Surgical became a wholly owned subsidiary of SafeStitch. On December 6, 2013, SafeStitch changed its name to TransEnterix, Inc.

### **Results of Operations**

Our results of operations include the acquired SafeStitch operations from the Merger date, September 3, 2013, forward and the operations of TransEnterix Italia from the Senhance Acquisition date of September 21, 2015 forward.

#### **Revenue**

In the third quarter of 2016, our revenue consisted of product and service revenue resulting from the sale in Europe of a Senhance System, instruments and accessories, and related services. We recognize revenue when persuasive evidence that an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable, and collectability is reasonably assured. Amounts billed in excess of the associated revenue recognized are deferred.

We expect to experience some unevenness in the number and trend, and average selling price, of units sold on a quarterly basis given the early stage of commercialization of our products.

Product and service revenue for the three and nine months ended September 30, 2016 increased to \$1.5 million. This increase was the result of the sale of one Senhance System during the quarter, after allowing for the associated deferred revenue.

## **Cost of Revenue**

Cost of revenues consists primarily of costs related to contract manufacturing, materials, and manufacturing overhead. We expense all inventory provisions as cost of revenues. The manufacturing overhead costs include the cost of quality assurance, material procurement, inventory control, facilities, equipment depreciation and operations supervision and management. We expect overhead costs as a percentage of revenues to become less significant as our production volume increases. We expect cost of revenues to increase in absolute dollars to the extent our revenues grow and as we continue to invest in our operational infrastructure to support anticipated growth.

Cost of revenue for the three and nine months ended September 30, 2016 increased to \$1.0 million, primarily representing the fair value of the system determined using the acquisition method of accounting at the acquisition date. This increase over the prior year period was the result of the costs recognized in connection with the sale of one Senhance System during the quarter.

## **Research and Development**

Research and development (“R&D”) expenses primarily consist of engineering, product development and regulatory expenses incurred in the design, development, testing and enhancement of our products and legal services associated with our efforts to obtain and maintain broad protection for the intellectual property related to our products. In future periods, we expect R&D expenses to remain consistent or be modestly higher as we continue to invest in basic research, clinical studies, product development and intellectual property supporting the evolution of our Senhance System. R&D expenses are expensed as incurred.

R&D expenses for the three months ended September 30, 2016 and 2015 remained relatively consistent at \$7.0 million. These expenses included decreased supplies expense of \$2.3 million and decreased personnel related costs of \$0.6 million, offset by increased preclinical lab expense of \$2.4 million and increased other expenses of \$0.5 million.

R&D expenses for the nine months ended September 30, 2016 increased to \$21.8 million as compared to \$21.1 million for the nine months ended September 30, 2015. The \$0.7 million increase resulted primarily from increased preclinical lab expense of \$2.5 million, increased personnel related costs of \$1.0 million, increased facility costs of \$0.8 million, and increased stock compensation costs of \$0.7 million offset by decreased supplies expense of \$2.6 million and decreased contract engineering services, consulting and other outside services of \$1.7 million.

## **Sales and Marketing**

Sales and marketing expenses include costs for sales and marketing personnel, travel, demonstration product, market development, physician training, tradeshows, marketing clinical studies and consulting expenses. We expect sales and marketing expenses to increase significantly in 2016 in support of our Senhance System product launch.

Sales and marketing expenses for the three months ended September 30, 2016 increased to \$2.6 million compared to \$0.4 million for the three months ended September 30, 2015. The \$2.2 million increase was primarily related to increased personnel related costs of \$1.0 million, increased depreciation expense \$0.5 million, increased travel related expenses of \$0.3 million, and increased other costs of \$0.4 million.

Sales and marketing expenses for the nine months ended September 30, 2016 increased to \$5.6 million compared to \$1.2 million for the nine months ended September 30, 2015. The \$4.4 million increase was primarily related to increased personnel related costs of \$1.8 million, increased travel related expenses of \$0.6 million, increased depreciation expense \$0.4 million, increased tradeshow costs of \$0.4 million, increased consulting costs of \$0.4 million, and increased other costs of \$0.8 million.

## **General and Administrative**

General and administrative expenses consist of personnel costs related to the executive, finance and human resource functions, as well as professional service fees, legal fees, accounting fees, insurance costs, and general corporate expenses. In future periods, we expect general and administrative expenses to increase to support our sales, marketing, and research and development efforts.

General and administrative expenses for the three months ended September 30, 2016 increased to \$2.8 million compared to \$1.8 million for the three months ended September 30, 2015. The \$1.0 million increase was primarily due to increased legal, accounting, and investor relation fees and other public company costs of \$0.6 million, increased stock compensation costs of \$0.2 million and increased other costs of \$0.2 million.

General and administrative expenses for the nine months ended September 30, 2016 increased to \$7.9 million compared to \$5.6 million for the nine months ended September 30, 2015. The \$2.3 million increase was primarily due to increased legal, accounting, and investor relation fees and other public company costs of \$1.2 million, increased personnel costs of \$0.5 million, increased stock compensation costs of \$0.4 million, and increased other costs of \$0.2 million.

#### **Amortization of Intangible Assets**

Amortization of intangible assets for the three months ended September 30, 2016 increased to \$1.7 million compared to \$0.3 million for the three months ended September 30, 2015. The \$1.4 million increase was primarily the result of amortization of developed technology related to the acquisition of the Senhance System on September 21, 2015.

Amortization of intangible assets for the nine months ended September 30, 2016 increased to \$5.3 million compared to \$0.6 million for the nine months ended September 30, 2015. The \$4.7 million increase was primarily the result of amortization of developed technology related to the acquisition of the Senhance System on September 21, 2015.

#### **Change in Fair Value of Contingent Consideration**

The change in fair value of contingent consideration in connection with the Senhance Acquisition was a reduction of \$0.1 million for the three months ended September 30, 2016 primarily related to the impact of foreign currency exchange rates.

The change in fair value of contingent consideration in connection with the Senhance Acquisition was an increase of \$1.7 million for the nine months ended September 30, 2016 primarily related to the effect of the passage of time on the fair value measurement and the impact of foreign currency exchange rates.

#### **Inventory write-down related to restructuring**

On April 19, 2016, the FDA notified the Company that the SurgiBot System did not meet the criteria for substantial equivalence based on the data submitted in the 510(k) submission. As a result, we reprioritized our near-term regulatory efforts to the 510(k) submission for the Senhance System. Consequently, in May 2016, the Company implemented a restructuring plan. Under this plan, we recorded a \$2.6 million write-down of inventory related to the SurgiBot System.

#### **Restructuring and other charges**

Under the restructuring plan executed in May 2016, we recorded \$3.1 million in restructuring and other charges. The restructuring charges included: (i) \$0.5 million to be paid in cash, of which \$0.4 million related to employee severance costs and \$0.1 million related to cancellation of certain contracts; and (ii) \$2.6 million for other non-cash charges, of which \$1.0 million related to the write-off of long-lived assets for the abandonment of certain equipment and tooling and \$1.6 million related to the write-off of intellectual property for certain patents.

#### **Goodwill impairment**

The Company performs an annual impairment test of goodwill at December 31, or more frequently if events or changes in circumstances indicates that the carrying value of our one reporting unit may not be recoverable. During the second quarter of 2016, we were notified by the FDA that the SurgiBot System did not meet the criteria for substantial equivalency, negatively impacting our market capitalization, and warranting an interim two-step quantitative impairment test. Based on the impairment test, we recorded goodwill impairment of \$61.8 million during the second quarter of 2016.

#### **Other Expense, Net**

Other expense is primarily composed of interest expense on notes payable.

Other expense for the three months ended September 30, 2016 increased to \$0.5 million compared to \$0.4 million for the three months ended September 30, 2015. The \$0.1 million increase was primarily related to the increase in notes payable of approximately \$10.0 million in August 2015.

Other expense for the nine months ended September 30, 2016 increased to \$1.4 million compared to \$1.0 million for the nine months ended September 30, 2015. The \$0.4 million increase was primarily related to the increase in notes payable of approximately \$10.0 million in August 2015.



## Income Tax Benefit

Income tax benefit consists primarily of taxes related to the amortization of purchase accounting intangibles in connection with the Italian taxing jurisdiction for TransEnterix Italia as a result of the acquisition of the Senhance System. We recognized \$1.0 million and \$4.7 million of income tax benefit for the three and nine months ended September 30, 2016, respectively.

## Liquidity and Capital Resources

### Sources of Liquidity

Since our inception we have incurred significant losses and, as of September 30, 2016, we had an accumulated deficit of \$288.9 million. We have not yet achieved profitability and we cannot assure investors that we will achieve profitability with our existing capital resources. Our recurring losses raise substantial doubt about our ability to continue as a going concern. As a result, the Company's independent registered public accounting firm included an explanatory paragraph in its report on our consolidated financial statements as of and for the years ended December 31, 2015, 2014 and 2013 with respect to this uncertainty. We expect to continue to fund research and development, sales and marketing and general and administrative expenses at similar to current or higher levels and, as a result, we will need to generate significant revenues to achieve profitability. Our principal sources of cash to date have been proceeds from public offerings of common stock, private placements of common and preferred stock, incurrence of debt and the sale of equity securities held as investments.

We currently have two effective shelf registration statements on file with the SEC, each of which were initially filed to register up to \$100.0 million of debt securities, common stock, preferred stock, or warrants, or any combination thereof for future financing transactions. In March 2016, the November 2014 shelf registration statement was increased by \$50.0 million. From April 2014 through June 2016, we have raised \$178.8 million in gross proceeds and approximately \$168.4 million in net proceeds under such shelf registration statements through public offerings of our securities. As of September 30, 2016 we had \$71.2 million available for future financings under such shelf registration statements, including approximately \$2.4 million available under the 2016 ATM Offering.

At September 30, 2016, we had cash and cash equivalents of approximately \$42.5 million.

### Consolidated Cash Flow Data

| (in thousands)   | <u>Nine Months<br/>Ended<br/>September 30,</u> | <u>Nine Months<br/>Ended<br/>September 30,</u> |
|--|--|--|
| Net cash (used in) provided by                               |  |  |
| Operating activities   | \$ (47,618)                                    | \$ (24,575)                                    |
| Investing activities   | (878)  | (25,728)                                       |
| Financing activities   | 52,698   | 68,430   |
| Effect of exchange rate changes on cash and cash equivalents | (133)  | —  |
| Net increase in cash and cash equivalents                    | \$ 4,069                                       | \$ 18,127                                      |

### Operating Activities

For the nine months ended September 30, 2016, cash used in operating activities of \$47.6 million consisted of net loss of \$106.0 million and cash used for working capital of \$16.4 million, offset by non-cash items of \$74.8 million. The non-cash items primarily consisted of \$61.8 million goodwill impairment, \$2.6 million inventory write-down related to restructuring, \$2.6 million non-cash restructuring and other charges, \$3.9 million of stock-based compensation expense, \$1.5 million of depreciation, \$5.3 million of amortization, and \$1.7 million change in fair value of contingent consideration, offset by \$4.7 million deferred income tax benefit. The decrease in cash from changes in working capital included \$10.4 million increase in restricted cash, \$1.9 million increase in inventories, \$1.9 million decrease in accounts payable, \$1.3 million increase in other current and long term assets, \$0.8 million increase in accounts receivable, and \$0.2 million decrease in accrued expenses.

### Investing Activities

For the nine months ended September 30, 2016, net cash used in investing activities was \$0.9 million. This amount reflected the purchases of property and equipment.

### ***Financing Activities***

For the nine months ended September 30, 2016, net cash provided by financing activities was \$52.7 million. This amount was primarily related to \$57.6 million in proceeds from the issuance of common stock, net of issuance costs, partially offset by \$5.0 million in payments of debt.

### **Operating Capital and Capital Expenditure Requirements**

We believe that our existing cash and cash equivalents, together with cash received from sales of our products, will not be sufficient to meet our anticipated cash needs through at least the next 12 months. We intend to spend substantial amounts on commercial activities, on research and development activities, including product development, regulatory and compliance, clinical studies in support of our future product offerings, and the enhancement and protection of our intellectual property, and on contingent consideration payments in connection with the acquisition of the Senhance System. We will need to obtain additional financing to pursue our business strategy, to respond to new competitive pressures or to take advantage of opportunities that may arise. To meet our capital needs, we are considering multiple alternatives, including, but not limited to, additional equity financings, debt financings and other funding transactions. There can be no assurance that we will be able to complete any such transaction on acceptable terms or otherwise. If we are unable to obtain the necessary capital, we will need to pursue a plan to license or sell our assets, seek to be acquired by another entity, cease operations and/or seek bankruptcy protection.

Cash and cash equivalents held by our foreign subsidiary totaled \$1.7 million at September 30, 2016. We do not intend or currently foresee a need to repatriate cash and cash equivalents held by our foreign subsidiary. If these funds are needed in the U.S., we believe that the potential U.S. tax impact to repatriate these funds would be immaterial.

### **Loan Agreement**

In connection with the Merger, in September we assumed and became the borrower under TransEnterix Surgical's then outstanding credit facility (the "Loan Agreement"). We have entered into a number of amendment and restatements of the Loan Agreement since that time, including the Consent and Second Amendment (the "Second Amendment") in connection with the Senhance Acquisition in September 2015. Under the Loan Agreement, as amended, our borrowing capacity is \$20.0 million, all of which is borrowed under term loans. We have had periods of interest-only payments during the Loan Agreement, as amended. Under the Second Amendment we made interest-only payments at 7.5% per annum on the term loans until January 31, 2016. The Second Amendment has a maturity date of July 1, 2018.

In connection with the entry into the Loan Agreement and amendments, we became obligated to pay final payment and facility fees. The final payment fee obligation payable under the Second Amendment is 6.5% of the original principal amount of each term loan.

In addition, in connection with the borrowings, we issued warrants to the Lenders to purchase shares of the Company's common stock as follows:

| <u>Date of issuance</u> | <u>Common stock<br/>underlying<br/>warrants</u> | <u>Expiration date</u> |
|-------------------------|---|------------------------|
| 01/17/2012              | 279,588   | 01/17/2019             |
| 09/26/2014              | 38,324  | 09/26/2021             |
| 08/14/2015              | 112,903   | 08/14/2022             |
| TOTAL                   | <u>430,815</u>                                  |                        |

The Loan Agreement, as amended and restated (the "Amended and Restated Loan Agreement"), is secured by a security interest in all assets of the Company and its current and future U.S. subsidiaries, including a security interest in intellectual property proceeds, but excluding a current security interest in intellectual property. The Amended and Restated Loan Agreement contains customary representations (tested on a continual basis) and covenants that, subject to exceptions, restrict our ability to do the following things: declare dividends or redeem or repurchase equity interests; incur additional liens; make loans and investments; incur additional indebtedness; engage in mergers, acquisitions, and asset sales; transact with affiliates; undergo a change in control; add or change business locations; and engage in businesses that are not related to its existing business.

Further, under the Second Amendment, the Lenders consented to the formation of TransEnterix International, the entry of the Company into the Purchase Agreement and other transaction documents, and the name change of TransEnterix Italia. We agreed to pledge 100% of the common stock of TransEnterix International as additional security for the borrowings under the Amended and Restated Loan Agreement, as amended. The Second Amendment added a provision permitting the Company to transfer designated amounts to TransEnterix Italia during the term of the Amended and Restated Loan Agreement. This provision for the transfer of

designated amount was amended on November 13, 2015 with the Third Amendment to the Amended and Restated Loan Agreement. The Fourth Amendment pursuant to which TransEnterix International joined the Loan Agreement and the existing promissory notes as a co-borrower thereunder and pledged, as collateral for the obligations under the Loan Agreement, substantially all of its non-intellectual property assets, including up to 65% of the equity interests owned by TransEnterix International in TransEnterix Europe S.á.r.l., a wholly owned subsidiary of International was entered into on April 19, 2016. On September 7, 2016, we and our U.S. subsidiaries entered into the Fifth Amendment to the Loan Agreement (the “Fifth Amendment”). The Fifth Amendment provides more flexibility to the Company with respect to its intercompany activities with its foreign subsidiaries and adds an affirmative covenant requiring the Company to maintain a \$10.0 million cash balance in accounts held with the Lender.

### **Off-Balance Sheet Arrangements**

As of September 30, 2016, we did not have any off-balance sheet arrangements.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations set forth above under the headings “Results of Operations” and “Liquidity and Capital Resources” have been prepared in accordance with U.S. GAAP and should be read in conjunction with our financial statements and notes thereto appearing in the Annual Report on Form 10-K for the year ended December 31, 2015, filed by the Company with the SEC on March 3, 2016. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our critical accounting policies and estimates, including identifiable intangible assets and goodwill, business acquisitions, in-process research and development, contingent consideration, stock-based compensation, and inventory. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. A more detailed discussion on the application of these and other accounting policies can be found in Note 2 in the Notes to the Financial Statements in the Annual Report on Form 10-K for the year ended December 31, 2015, filed by the Company with the SEC on March 3, 2016. Actual results may differ from these estimates under different assumptions and conditions.

While all accounting policies impact the financial statements, certain policies may be viewed as critical. Critical accounting policies are those that are both most important to the portrayal of financial condition and results of operations and that require management’s most subjective or complex judgments and estimates. Our management believes the policies that fall within this category are the policies on accounting for identifiable intangible assets and goodwill, business acquisitions, in-process research and development, contingent consideration, stock-based compensation, inventory, and revenue recognition.

#### **Identifiable Intangible Assets and Goodwill**

Identifiable intangible assets consist of purchased patent rights recorded at cost and developed research and development acquired as part of a business acquisition recorded at estimated fair value. Intangible assets are amortized over 7 to 10 years. We periodically evaluate identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Indefinite-lived intangible assets, such as goodwill, are not amortized. We test the carrying amounts of goodwill for recoverability on an annual basis or when events or changes in circumstances indicate evidence of potential impairment exists by performing either a qualitative evaluation or a two-step quantitative test. The qualitative evaluation is an assessment of factors, including industry, market and general economic conditions, market value, and future projections to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. The Company may elect to bypass this qualitative assessment and perform a two-step quantitative test. The quantitative goodwill impairment test is performed using a two-step approach. In the first step, the fair value of the reporting unit is determined and compared to the reporting unit's carrying value, including goodwill. If the fair value of the reporting unit is less than its carrying value, the second step of the goodwill impairment test is performed to measure the amount of impairment, if any. In the second step, the fair value of the reporting unit is allocated to the assets and liabilities of the reporting unit as if it had been acquired in a business combination and the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared to the actual carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, an impairment loss is recognized for the difference.

We performed a qualitative assessment during the annual impairment review for fiscal 2015 as of December 31, 2015 and concluded that it is not more likely than not that the fair value of our single reporting unit is less than its carrying amount. Therefore, the two-step goodwill impairment test for the reporting unit was not necessary in fiscal 2015. During the second quarter of 2016, the FDA notified

the Company that the SurgiBot System did not meet the criteria for substantial equivalency, negatively impacting the Company's market capitalization, and warranting an interim two-step quantitative impairment test. We determined the fair value of our reporting unit using a discounted cash flow analysis derived from the Company's long-term plans. The fair value of the reporting unit was corroborated using market prices for TransEnterix, Inc. The inputs used to determine the fair values were classified as Level 3 in the fair value hierarchy. Based on the impairment test, we recorded goodwill impairment of \$61.8 million during the second quarter of 2016.

### **Business Acquisitions**

Business acquisitions are accounted for using the acquisition method of accounting in accordance with Accounting Standards Codification ("ASC") 805, "Business Combinations." ASC 805 requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values, as determined in accordance with ASC 820, "Fair Value Measurements," as of the acquisition date. For certain assets and liabilities, book value approximates fair value. In addition, ASC 805 establishes that consideration transferred be measured at the closing date of the acquisition at the then-current market price, which may be different than the amount of consideration assumed in the pro forma financial statements. Under ASC 805, acquisition-related costs (i.e., advisory, legal, valuation and other professional fees) and certain acquisition-related restructuring charges impacting the target company are expensed in the period in which the costs are incurred. The application of the acquisition method of accounting requires the Company to make estimates and assumptions related to the estimated fair values of net assets acquired.

Significant judgments are used during this process, particularly with respect to intangible assets. Generally, intangible assets are amortized over their estimated useful lives. Goodwill and other indefinite-lived intangibles are not amortized, but are annually assessed for impairment. Therefore, the purchase price allocation to intangible assets and goodwill has a significant impact on future operating results.

### **In-Process Research and Development**

In-process research and development, or IPR&D, assets are considered to be indefinite-lived until the completion or abandonment of the associated research and development projects. IPR&D assets represent the fair value assigned to technologies that we acquire, which at the time of acquisition have not reached technological feasibility and have no alternative future use. During the period that the assets are considered indefinite-lived, they are tested for impairment on an annual basis, or more frequently if we become aware of any events occurring or changes in circumstances that indicate that the fair value of the IPR&D assets are less than their carrying amounts. If and when development is complete, which generally occurs when we have regulatory approval and are able to commercialize products associated with the IPR&D assets, these assets are then deemed definite-lived and are amortized based on their estimated useful lives at that point in time. If development is terminated or abandoned, we may have a full or partial impairment charge related to the IPR&D assets, calculated as the excess of carrying value of the IPR&D assets over fair value.

### **Contingent Consideration**

Contingent consideration is recorded as a liability and measured at fair value using a discounted cash flow model utilizing significant unobservable inputs including the probability of achieving each of the potential milestones and an estimated discount rate associated with the risks of the expected cash flows attributable to the various milestones. Significant increases or decreases in any of the probabilities of success or changes in expected timelines for achievement of any of these milestones would result in a significantly higher or lower fair value of these milestones, respectively, and commensurate changes to the associated liability. The fair value of the contingent consideration at each reporting date will be updated by reflecting the changes in fair value in our statement of operations.

### **Stock-Based Compensation**

We recognize as expense, the grant-date fair value of stock options and other stock based compensation issued to employees and non-employee directors over the requisite service periods, which are typically the vesting periods. We use the Black-Scholes-Merton model to estimate the fair value of our stock-based payments. The volatility assumption used in the Black-Scholes-Merton model is based on the calculated historical volatility based on an analysis of reported data for a peer group of companies. The expected term of options granted by us has been determined based upon the simplified method, because we do not have sufficient historical information regarding our options to derive the expected term. Under this approach, the expected term is the mid-point between the weighted average of vesting period and the contractual term. The risk-free interest rate is based on U.S. Treasury rates whose term is consistent with the expected life of the stock options. We have not paid and do not anticipate paying cash dividends on our shares of common stock; therefore, the expected dividend yield is assumed to be zero. We estimate forfeitures based on our historical experience and adjust the estimated forfeiture rate based upon actual experience.

## Inventory

Inventory, which includes material, labor and overhead costs, is stated at cost, and determined on a first-in, first-out basis, not in excess of market value. We record reserves, when necessary, to reduce the carrying value of inventory to its net realizable value. At the point of loss recognition, a new, lower-cost basis for that inventory is established, and any subsequent improvements in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

## Revenue Recognition

Our revenue consists of product revenue resulting from the sales of systems, instruments and accessories, and service revenue. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable, and collectability is reasonably assured. Revenue is presented net of taxes collected from customers that are remitted to government authorities. We generally recognize revenue at the following points in time:

- System sales.* For systems sold directly to end customers, revenue is recognized when acceptance occurs, which is deemed to have occurred upon customer acknowledgment of delivery or installation, depending on the terms of the arrangement. The Senhance Systems are delivered with a software component. However, because the software and non-software elements function together to deliver the system's essential functionality, our arrangements are excluded from being accounted for under software revenue recognition guidance.

- Instruments and accessories.* Revenue from sales of instruments and accessories is generally recognized at the time of shipment.

- Service.* Service revenue is recognized ratably over the term of the service period. Revenue related to services performed on a time-and-materials basis is recognized when it is earned and billable.

Our system sale arrangements contain multiple elements including a system(s), instruments, accessories, and system service. We generally deliver all of the elements, other than service, within days of entering into the system sale arrangement. Each of these elements is a separate unit of accounting. System accessories, instruments, accessories and service are also sold on a stand-alone basis.

For multiple-element arrangements, revenue is allocated to each unit of accounting based on their relative selling prices. Relative selling prices are based first on vendor specific objective evidence of fair value ("VSOE"), then on third-party evidence of selling price ("TPE") when VSOE does not exist, and then on management's best estimate of the selling price ("BESP") when VSOE and TPE do not exist.

Our system sale arrangements generally include a one-year period of free service, and the right for the customer to purchase service annually thereafter. The revenue allocated to the free service period is deferred and recognized ratably over the free service period. Deferred revenue was primarily comprised of deferred revenue related to service contracts for the periods presented.

Because we have neither VSOE nor TPE for our systems, the allocation of revenue is based on BESP for the systems sold. The objective of BESP is to determine the price at which we would transact a sale, had the product been sold on a stand-alone basis. We determine BESP for our systems by considering multiple factors, including, but not limited to, features and functionality of the system, geographies, type of customer, and market conditions. We regularly review BESP and maintain internal controls over establishing and updating these estimates.

## Recent Accounting Pronouncements

See "Note 2. Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, filed by the Company with the SEC on March 3, 2016, for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on Consolidated Balance Sheets and Consolidated Statements of Operations and Comprehensive Loss.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### General

We have limited exposure to market risks from instruments that may impact the Balance Sheets, Statements of Operations and Comprehensive Loss, and Statements of Cash Flows. Such exposure is due primarily to changing interest rates.

## Interest Rates

The primary objective for our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing excess cash in money market funds and Treasury securities. As of September 30, 2016, approximately 100% of the investment portfolio was in cash equivalents with very short term maturities and therefore not subject to any significant interest rate fluctuations.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2016. We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2016, our principal executive officer and principal financial officer concluded that, as of such a date, our disclosure controls and procedures were effective at the reasonable assurance level.

### Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the last quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1 Legal Proceedings

On June 2, 2016, a stockholder filed a putative class action complaint, *Ashok V. Bankley, individually and on behalf of all others similarly situated vs. TransEnterix, Inc., Todd M. Pope and Joseph P. Slattery*, in the United States District Court for the Eastern District of North Carolina (Case No. 5:16-cv-00313-D) (the "Initial Complaint"), against the Company and two of its executive officers on behalf of all persons who purchased or otherwise acquired the Company's common stock between February 10, 2016 and May 10, 2016. On August 4, 2016, the defendants filed a motion to dismiss the Initial Complaint for failure to state a claim under the securities laws. On August 30, 2016, the court appointed Randall Clark, Samir Patel, the Underhill Cemetery Association, and the North Underhill Cemetery Association as the lead plaintiffs in the Initial Complaint, and also provided the plaintiffs an opportunity to amend the Initial Complaint. On September 26, 2016, the lead plaintiffs filed an Amended Complaint. Among other things, the Amended Complaint asserts revised claims against the Company and Messrs. Pope and Slattery, and adds claims against certain current and former members of the Company's Board of Directors, and Cantor Fitzgerald & Co., the sales agent under the 2016 Sales Agreement, under which the Company offered and sold, through Cantor, shares of common stock in its 2016 ATM Offering. The Amended Complaint alleges that the defendants made false and misleading public statements related to the Company's SurgiBot System and its 510(k) application in violation of certain federal securities laws. The Amended Complaint seeks class certification of a class consisting of all persons who purchased or otherwise acquired the Company's common stock between February 10, 2016 and May 10, 2016, class certification of a subclass of persons who purchased or otherwise acquired the Company's common stock in connection with the 2016 ATM Offering between February 9, 2016 and April 19, 2016, unspecified monetary damages, costs, and attorneys' fees. On November 8, 2016, the defendants moved to dismiss the Amended Complaint.

On June 9, 2016, a different stockholder filed another putative class action complaint, *Thomas Ravey, individually and on behalf of all others similarly situated vs. TransEnterix, Inc., Todd M. Pope and Joseph P. Slattery*, in the United States District Court for the Middle District of North Carolina (Case No. 1:16-cv-599) (the "Ravey Action"). The Ravey Action asserted substantially similar claims against the same defendants and seeks substantially similar relief as the Initial Complaint. On August 4, 2016, the plaintiff in the Ravey Action voluntarily dismissed the Ravey Action.

On July 8, 2016, a stockholder filed a putative derivative complaint, *Otto Pikal v. Todd M. Pope, et al.*, in the General Court of Justice, Superior Court Division, Wake County, North Carolina (case number 16CV008930), on behalf of the Company against certain of our current officers and directors. The complaint alleges, among other things, that the defendants breached their fiduciary duties by disseminating false and misleading information to the Company's shareholders relating to the Company's SurgiBot System

and its 510(k) application in violation of certain federal securities laws and by failing to ensure that the Company maintained adequate internal controls. The complaint seeks, among other things, unspecified monetary damages and an order directing the Company to take steps to improve its corporate governance and to protect the Company and its stockholders from future wrongdoing such as that alleged in the complaint. On September 29, 2016, the court entered an order staying the litigation pending resolution of the motion to dismiss the Amended Complaint in the *Bankley* Action.

On April 25, 2016, Intuitive Surgical, Inc. and its French subsidiary, Intuitive Surgical SAS (collectively, "Intuitive"), brought a request for unilateral measures of enquiry in front of the President of the Commercial Court of Toulon (France) (the "President") against two employees of TransEnterix International, Inc. alleging that the company, through these two employees, engaged in acts of unfair competition. On May 3, 2016, the President rendered an order granting Intuitive's request for unilateral measures of enquiry with respect to its allegations (the "Order"). On June 28, 2016, TransEnterix International filed a writ challenging the Order and requesting that it be withdrawn by the President. On September 7, 2016, the President rendered his decision on TransEnterix International's challenge (the "Ruling") and ruled in favor of TransEnterix International. Under the Ruling, the Intuitive unilateral measures of enquiry were declared to be unjustified and the Order was withdrawn. The President also declared that the Ruling was provisionally enforceable. Intuitive has filed an appeal against the Ruling (the "Appeal") with the Court of Appeal of Aix-en-Provence (France). No hearing date for the Appeal has yet been noticed. In addition, because Intuitive did not comply with the Ruling, TransEnterix International filed a dismissal request against the Appeal with the same Court of Appeal (the "Dismissal Request"). A hearing has been scheduled on January 3, 2017 with respect to the Dismissal Request.

Based on the stage of the proceedings, we have determined that the amount of any possible loss or range of possible loss in connection with the above matters is not reasonably estimable.

**Item 1A Risk Factors.**

Reference is made to the Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2015, and in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, for our current risk factors.

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

On September 14, 2016, the Board of Directors approved the issuance of up to 150,000 shares of common stock to a vendor of the Company in lieu of a cash payment. To date, the Company has issued to such vendor 81,032 shares of the Company's common stock. The issuance of the foregoing securities were exempt from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act") afforded by Section 3(a)(9) or 4(a)(2) thereof and Regulation D promulgated thereunder, which exception we believe is available because the securities were not offered pursuant to a general solicitation and such issuances were otherwise made in compliance with the requirements of Regulation D and Rule 506. The securities issued in this transaction may not be resold except pursuant to an effective registration statement filed under the Securities Act or pursuant to a valid exemption from the registration requirements of the Securities Act.

**Item 3 Defaults Upon Senior Securities.**

None.

**Item 4 Mine Safety Disclosures.**

Not applicable.

**Item 5 Other Information.**

None.

**Item 6. Exhibits.**

| Exhibit No. | Description   |
|-------------|---|
| 10.1        | Fifth Amendment to Amended and Restated Loan and Security Agreement, dated September 7, 2016, by and among TransEnterix, Inc., TransEnterix Surgical, Inc., SafeStitch LLC and TransEnterix International, Inc., as Borrower, and Oxford Finance LLC, as Lender and Collateral Agent, and Silicon Valley Bank, as Lender (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 8, 2016). |
| 31.1*       | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)*  |
| 31.2*       | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)*  |
| 32.1*       | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*   |
| 32.2*       | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*   |
| 101.INS     | XBRL Instance Document*   |
| 101.SCH     | XBRL Taxonomy Extension Schema Document*  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document*  |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document*   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document*  |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document*   |

\* Filed or furnished herewith.



**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.

**TransEnterix, Inc.**

Date: November 9, 2016

By: /s/ Todd M. Pope  
Todd M. Pope  
President and Chief Executive Officer

Date: November 9, 2016

By: /s/ Joseph P. Slattery  
Joseph P. Slattery  
Executive Vice President and Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13A-14(A)/15D-14(A)**

I, Todd M. Pope, certify that:

1. I have reviewed this quarterly report on Form 10-Q of TransEnterix, 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 we 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 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.

Date: November 9, 2016

/s/ Todd M. Pope

Todd M. Pope

President and Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13A-14(A)/15D-14(A)**

I, Joseph P. Slattery, certify that:

1. I have reviewed this quarterly report on Form 10-Q of TransEnterix, 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 we 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 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.

Date: November 9, 2016

/s/ Joseph P. Slattery

Joseph P. Slattery

Executive Vice President and Chief Financial Officer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Todd M. Pope, hereby certify pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and 18 U.S.C. Section 1350, that the Quarterly Report on Form 10-Q of TransEnterix, Inc. (the "Company") for the quarterly period ended September 30, 2016 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 9, 2016

By: /s/ Todd M. Pope  
Todd M. Pope  
President and Chief Executive Officer

This certification accompanies the Report pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Exchange Act and 18 U.S.C. Section 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Exchange Act, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this certification has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph P. Slattery, hereby certify pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and 18 U.S.C. Section 1350, that the Quarterly Report on Form 10-Q of TransEnterix, Inc. (the "Company") for the quarterly period ended September 30, 2016 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 9, 2016

By: /s/ Joseph P. Slattery  
Joseph P. Slattery  
Executive Vice President and Chief Financial Officer

This certification accompanies the Report pursuant to Rule 13a-14(b) or Rule 15d-14(b) under the Exchange Act and 18 U.S.C. Section 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Exchange Act, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this certification has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.