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

Form 10-Q

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

For the quarterly period ended March 31, 2021

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: 1-33818

RESHAPE LIFESCIENCES INC.

(Exact name of registrant as specified in its charter)

Delaware	**48-1293684**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1001 Calle Amanecer, San Clemente, California 92673
(Address of principal executive offices, including zip code)

(949) 429-6680
(Registrant's telephone number, including area code)

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

Title of Each Class	**Trading Symbol**	**Name of Each Exchange on which Registered**
Common stock, $0.001 par value per share	RSLS	OTCQB Market

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

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

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

Large accelerated filer	☐	Accelerated Filer	☐
Non-accelerated filer	☒	Smaller Reporting Company	☒
Emerging Growth Company	☐		

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

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

As of May 14, 2021, 6,166,554 shares of the registrant's Common Stock were outstanding.

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PART I – FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

RESHAPE LIFESCIENCES INC.
Condensed Consolidated Balance Sheets
(dollars in thousands, except per share amounts; unaudited)

	March 31, 2021	December 31, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	$ 896	$ 2,957
Restricted cash	1,050	50
Accounts and other receivables (net of allowance for doubtful accounts of $442 and $968 respectively)	3,373	2,620
Inventory	2,095	2,244
Prepaid expenses and other current assets	836	1,073
Total current assets	8,250	8,944
Property and equipment, net	718	584
Operating lease right-of-use assets	390	465
Other intangible assets, net	26,612	27,022
Other assets	46	46
Total assets	$ 36,016	$ 37,061
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,637	$ 3,655
Accrued and other liabilities	4,017	3,630
Warranty liability, current	390	397
Debt, current portion, net of deferred financing costs	13,268	3,609
Operating lease liabilities, current	320	314
Total current liabilities	21,632	11,605
Debt, noncurrent portion	—	9,168
Operating lease liabilities, noncurrent	82	163
Warranty liability, noncurrent	979	1,022
Deferred income taxes	615	615
Total liabilities	23,308	22,573
Commitments, contingencies and subsequent events		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized:		
Series B convertible preferred stock, $0.001 par value; 3 issued and outstanding at March 31, 2021 and December 31, 2020, respectively	—	—
Series C convertible preferred stock, $0.001 par value; 95,388 shares issued and outstanding at March 31, 2021 and December 31, 2020	1	1
Common stock, $0.001 par value; 275,000,000 shares authorized at March 31, 2021 and December 31, 2020; 6,166,554 shares issued and outstanding at both March 31, 2021 and December 31, 2020	6	6
Additional paid-in capital	532,504	529,429
Accumulated deficit	(519,701)	(514,827)
Accumulated other comprehensive loss	(102)	(121)
Total stockholders' equity	12,708	14,488
Total liabilities and stockholders' equity	$ 36,016	$ 37,061

See accompanying notes to Condensed Consolidated Financial Statements.

RESHAPE LIFESCIENCES INC.

Condensed Consolidated Statements of Operations
(dollars in thousands, except per share amounts; unaudited)

	Three Months Ended March 31,	
	2021	2020
Revenue	$ 3,221	$ 2,789
Cost of revenue	937	1,285
Gross profit	2,284	1,504
Operating expenses:		
Sales and marketing	1,250	1,454
General and administrative	2,720	2,836
Research and development	571	1,295
Total operating expenses	4,541	5,585
Operating loss	(2,257)	(4,081)
Other expense (income), net:		
Interest expense, net	599	104
Loss on extinguishment of debt, net	1,960	—
Loss on foreign currency exchange	33	144
Loss before income tax provision	(4,849)	(4,329)
Income tax expense (benefit)	25	(18)
Net loss	$ (4,874)	$ (4,311)
Net loss per share - basic and diluted:		
Net loss per share - basic and diluted	$ (0.70)	$ (0.63)
Shares used to compute basic and diluted net loss per share	6,968,221	6,859,240

See accompanying notes to Condensed Consolidated Financial Statements.

RESHAPE LIFESCIENCES INC.

Condensed Consolidated Statements of Comprehensive Loss
(dollars in thousands; unaudited)

	Three Months Ended March 31,	
	2021	2020
Net loss	$ (4,874)	$ (4,311)
Foreign currency translation adjustments	19	(48)
Other comprehensive income (loss), net of tax	19	(48)
Comprehensive loss	$ (4,855)	$ (4,359)

See accompanying notes to Condensed Consolidated Financial Statements.

RESHAPE LIFESCIENCES INC.

Condensed Consolidated Statements of Stockholders' Equity
(dollars in thousands; unaudited)

	Three Months Ended March 31, 2021									
	Series B Convertible Preferred Stock		Series C Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance December 31, 2020	3	$ —	95,388	$ 1	6,166,554	$ 6	$ 529,429	$ (514,827)	$ (121)	$ 14,488
Net loss	—	—	—	—	—	—	—	(4,874)	—	(4,874)
Other comprehensive income, net of tax	—	—	—	—	—	—	—	—	19	19
Stock-based compensation expense	—	—	—	—	—	—	101	—	—	101
Issuance of warrants	—	—	—	—	—	—	2,974	—	—	2,974
Balance March 31, 2021	3	$ —	95,388	$ 1	6,166,554	$ 6	$ 532,504	$ (519,701)	$ (102)	$ 12,708

	Three Months Ended March 31, 2020									
	Series B Convertible Preferred Stock		Series C Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance December 31, 2019	3	$ —	95,388	$ 1	391,739	$ —	$ 517,311	$ (493,197)	$ (8)	$ 24,107
Net loss	—	—	—	—	—	—	—	(4,311)	—	(4,311)
Other comprehensive loss, net of tax	—	—	—	—	—	—	—	—	(48)	(48)
Stock-based compensation expense	—	—	—	—	—	—	427	—	—	427
Issuance of warrants	—	—	—	—	—	—	1,393	—	—	1,393
Balance March 31, 2020	3	$ —	95,388	$ 1	391,739	$ —	$ 519,131	$ (497,508)	$ (56)	$ 21,568

See accompanying Notes to Condensed Consolidated Financial Statements.

RESHAPE LIFESCIENCES INC.

Condensed Consolidated Statements of Cash Flows
(dollars in thousands; unaudited)

	Three Months Ended March 31,	
	2021	2020
Cash flows from operating activities:		
Net loss	$ (4,874)	$ (4,311)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	7	4
Amortization of intangible assets	411	417
Noncash interest expense	43	58
Loss on extinguishment of debt, net	1,960	—
Stock-based compensation	101	427
Bad debt expense	27	149
Provision for inventory excess and obsolescence	1	—
Amortization of debt discount and deferred debt issuance costs	461	47
Other noncash items	17	18
Change in operating assets and liabilities:		
Accounts and other receivables	(780)	848
Inventory	182	60
Prepaid expenses and other current assets	237	(274)
Accounts payable and accrued liabilities	296	(865)
Warranty liability	(50)	173
Other	—	4
Net cash used in operating activities	(1,961)	(3,245)
Cash flows from investing activities:		
Capital expenditures	(119)	—
Cash used in investing activities:	(119)	—
Cash flows from financing activities:		
Proceeds from credit agreement	1,000	2,500
Payments of financing costs	—	(25)
Net cash provided by financing activities	1,000	2,475
Effect of currency exchange rate changes on cash and cash equivalents	19	(48)
Net increase (decrease) in cash, cash equivalents and restricted cash	(1,061)	(818)
Cash, cash equivalents and restricted cash at beginning of period	3,007	2,985
Cash, cash equivalents and restricted cash at end of period	$ 1,946	$ 2,167
Supplemental disclosure:		
Cash paid for income taxes	$ 31	$ —
Noncash investing and financing activities:		
Fair value of warrants included as a component of loss on extinguishment of debt	$ 2,974	$ —
Relative fair value of warrants classified as debt issuance costs	—	1,393
Capital expenditures accruals	141	—

See accompanying notes to Condensed Consolidated Financial Statements.

ReShape Lifesciences Inc.

Notes to Condensed Consolidated Financial Statements
(dollars in thousands, except per share amounts; unaudited)

(1) Basis of Presentation

The accompanying interim condensed consolidated financial statements and related disclosures of Reshape Lifesciences Inc. (the “Company”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2020, filed on March 11, 2021. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been condensed or omitted.

In the opinion of management, the interim consolidated condensed financial statements reflect all adjustments considered necessary for a fair statement of the interim periods. All such adjustments are of a normal, recurring nature. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

Fair Value of Financial Instruments

The carrying amounts of cash equivalents, accounts receivable, accounts payable and certain accrued and other liabilities approximate fair value due to their short-term maturities. Refer to Note 5 regarding the fair value of debt instruments and Note 8 regarding fair value measurements and inputs of warrants.

Net Loss Per Share

The following table sets forth the potential shares of common stock that are not included in the calculation of diluted net loss per share because to do so would be anti-dilutive as of the end of each period presented:

	March 31,	
	2021	2020
Stock options	40	46
Convertible preferred stock	1,288	1,288
Warrants	14,483,446	8,342,428

Recent Accounting Pronouncements

New accounting standards adopted by the Company in 2021 are discussed below or in the related notes, where appropriate.

In December 2019, the FASB issued authoritative guidance intended to simplify the accounting for income taxes: ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. This guidance eliminates certain exceptions to the general approach to the income tax accounting model and adds new guidance to reduce the complexity in accounting for income taxes. The adoption of this guidance on January 1, 2021 did not have a material impact on the Company’s consolidated financial statements.

New accounting standards not yet adopted are discussed below.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*: Measurement of Credit Losses on Financial Instruments, which is intended to provide financial statement users with more useful information about expected credit losses on financial assets held by a reporting entity at each reporting date. In May 2019, the FASB issued ASU No. 2019-05, which amended the new standard by providing targeted transition relief. The new guidance replaces the existing incurred loss impairment methodology with a methodology that requires consideration of a broader range of reasonable and supportable forward-looking information to estimate all expected

credit losses. In November 2019, the FASB issued ASU No. 2019-11, which amended the new standard by providing additional clarification. This guidance is effective for the fiscal years and interim periods within those years beginning after December 15, 2022. The Company is currently evaluating the impact the guidance will have on its consolidated financial statements.

(2) Liquidity and Management's Plans

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company currently does not generate revenue sufficient to offset operating costs and anticipates such shortfalls to continue in the short-term. The Company's history of operating losses and limited cash resources and lack of certainty regarding obtaining significant third-party reimbursement of its products, raise substantial doubt about its ability to continue as a going concern.

As of March 31, 2021, the Company had net negative working capital of approximately $13.4 million. The Company's principal source of liquidity as of March 31, 2021 consisted of approximately $1.9 million of cash and cash equivalents and restricted cash, and $3.4 million of accounts receivable. During January 2021, the Company entered into a $15.0 million Line of Credit with an institutional investor, which has not been drawn upon as of March 31, 2021. For further details see Note 5.

The Company's anticipated operations include plans to (i) manufacture, and promote the sales and operations of the LAP-BAND® product line in order to expand sales domestically and internationally as well as to obtain cost savings synergies, (ii) introduce to the market place reshape**care**™, (iii) continue clinical testing of the ReShape Vest, (iv) continue development of the Diabetes Bloc-Stim Neuromodulation, (v) seek opportunities to leverage our intellectual property portfolio and custom development services to provide third-party sales and licensing opportunities, and (vi) explore and capitalize on synergistic opportunities to expend our portfolio and offer future minimally invasive treatments and therapies in the obesity continuum of care, which includes the pending merger with Obalon Therapeutics, Inc. pursuant to the merger agreement that was entered into with Obalon on January 19, 2021, for further details see Note 13. The Company believes that it has the flexibility to manage the growth of its expenditures and operations depending on the amount of available cash flows, which could include reducing expenditures for marketing, clinical and product development activities. However, the Company will ultimately need to achieve sufficient revenues from product sales and obtain additional debt or equity financing to support its operations.

COVID-19 Risk and Uncertainties and CARES Act

Additionally, on January 30, 2020, the World Health Organization ("WHO") announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (the "COVID-19 outbreak") and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally and on March 13, 2020, the United States declared a national emergency with respect to the coronavirus outbreak. This outbreak has severely impacted global economic activity, and many countries and many states in the United States have reacted to the outbreak by instituting quarantines, mandating business and school closures and restricting travel. These mandated business closures have at times included the cessation of non-elective surgeries in Australia, Europe and the United States for all but emergency procedures. As a result of these mandates, on April 16, 2020, the Company implemented various short-term cost reductions and cash flow improvement actions, such as reducing the compensation for executives, management and key employees and decreasing operating expenses where possible. In addition, the Company identified temporary headcount reductions and made the decision to furlough a portion of its workforce. During the second quarter of 2020, the mandated closures began to ease in many areas throughout the world and within the United States. As a result of this, elective surgeries started back up again through various parts of the world, which led to improved sales progressing through the third quarter. Even after the COVID-19 outbreak has subsided, the Company may continue to experience materially adverse impact on its financial condition and results of operation. Additionally, on June 15, 2020, the Company ended the temporary pay reductions and the furloughed employees returned to work. The full impact of the COVID-19 outbreak continues to evolve and it is uncertain as to the full magnitude that the pandemic will have on the Company's financial condition, liquidity, and future results of operations. Management is actively monitoring the impact of the global situation on the Company's financial condition, liquidity, operations, suppliers, industry, and workforce and has taken actions to mitigate the impact including among other things, temporary reductions in pay, and furloughs of certain positions along with deferrals in payment for cash preservation. Given the daily evolution of the COVID-19 outbreak and the global responses to curb its spread, the Company is not

able to estimate the effects of the COVID-19 outbreak on its results of operations, financial condition, or liquidity for fiscal year 2021.

On March 27, 2020, President Trump signed into law the "Coronavirus Aid, Relief, and Economic Security (CARES) Act." The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations, increased limitations on qualified charitable contributions, and technical corrections to tax depreciation methods for qualified improvement property. The CARES Act established the Paycheck Protection Program ("PPP") under which the Company received a PPP loan described in more detail in Note 8 below. On February 3, 2021, the Company submitted the application for PPP loan forgiveness according to the terms and conditions of the SBA's Loan Forgiveness Application (Revised June 24, 2002). On March 1, 2021, the Company received confirmation from the SBA that, the PPP Loan had been forgiven in full including all interest incurred. For further details, see Note 5.

(3) Supplemental Balance Sheet Information

Components of selected captions in the condensed consolidated balance sheets consisted of the following:

Inventory:

	March 31, 2021	December 31, 2020
Raw materials	$ 214	$ 174
Sub-assemblies	749	733
Finished goods	1,132	1,337
Total inventory	$ 2,095	$ 2,244

Prepaid expenses and other current assets:

	March 31, 2021	December 31, 2020
Prepaid insurance	$ 381	$ 619
Prepaid contract research organization expenses	214	295
Other	241	159
Total prepaid expenses and other current assets	$ 836	$ 1,073

Accrued and other liabilities:

	March 31, 2021	December 31, 2020
Payroll and benefits	$ 2,106	$ 1,735
Accrued professional services	556	446
Customer deposits	397	398
Taxes	358	265
Accrued insurance premium	287	272
Other	313	514
Total accrued and other liabilities	$ 4,017	$ 3,630

(4) Intangible Assets

Indefinite-lived intangible assets consist of in-process research and development ("IPR&D") for the ReShape Vest recorded in connection with the Company's acquisition of BarioSurg, Inc. The Company's finite-lived intangible assets consists of developed technology, trademarks and tradenames, and covenant not compete. The estimated useful lives of these finite-lived intangible assets ranges from 3 to 10 years. The amortization expenses for both the three months ended March 31, 2021 and 2020 was $0.4 million.

(5) Debt

	March 31, 2021	December 31, 2020
Asset purchase consideration	$ 2,902	$ 2,867
Credit agreement	10,500	9,500
PPP Loan	—	955
Total debt	13,402	13,322
Less: unamortized debt discount	134	545
Less: current portion of debt	13,268	3,609
Debt, noncurrent portion	$ —	$ 9,168

Credit Facility

On January 19, 2021, the Company entered into a $15.0 million Line of Credit with an institutional investor that the Company may access from time to time until December 31, 2022. As of March 31, 2021, the Company has not drawn down any amounts under the Credit Facility. Any advances would bear interest at a rate per annum equal to the LIBOR rate plus 2.5% and would be subject to the Guarantee and Collateral Agreement between the Company and the institutional investor dated March 25, 2020.

CARES Act

On April 24, 2020, the Company entered into a PPP Loan agreement with Silicon Valley Bank ("SVB") under the PPP, which is part of the CARES Act administered by the United States Small Business Administration ("SBA"). As part of the application for these funds, the Company in good faith, has certified that the current economic uncertainty made the loan request necessary to support the ongoing operations of the Company. This certification further requires the Company to take into account our current business activity and our ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. Under this program, the Company received proceeds of $1.0 million from the PPP Loan. In accordance with the requirements of the PPP, the Company intends to use proceeds from the PPP Loan primarily for payroll costs, rent and utilities. The PPP Loan has a 1.00% interest rate per annum, matures on April 24, 2022 and is subject to the terms and conditions applicable to loans administered by the SBA under the PPP.

On February 23, 2021, the Company submitted the application for PPP loan forgiveness, in accordance with the terms and conditions of the SBA's Loan Forgiveness Application (revised June 24, 2020). On March 1, 2021, the Company received confirmation from the SBA that the PPP Loan was forgiven in full including all interest incurred, which resulted in a gain on debt extinguishment of $1.0 million, during the three months ended March 31, 2021.

Under the provisions of the CARES Act, the Company is eligible for a refundable employee retention credit subject to certain criteria. The Company recognized a $0.3 million employee retention credit during the three months ended March 31, 2021.

Credit Agreement

On March 25, 2020, the Company executed a credit agreement up to $3.5 million, with an institutional investor (the "Lender"), who holds warrants in connection with the June 2019 and September 2019 transactions. On the day of closing, the Company received $2.5 million and the additional $1.0 million may be drawn from time to time 30 days after the closing date but prior to five months after the closing date, in $500 thousand increments per draw. On June 23,

2020, the Company made the first additional draw of $500 thousand and on July 29, 2020 the second $500 thousand draw was made. As required by the terms of this credit agreement, the lender exercised its warrants to purchase an aggregate of 5,085,834 shares of common stock with a current exercise price of $0.12 per warrant on April 15, 2020, in which the Company received net proceeds of $0.6 million. In addition, the Company issued to the lender 1,200,000 Series G warrants to purchase an aggregate of 1,200,000 shares of common stock. As an inducement to the Lender to enter into the amendment and make the additional loans contemplated thereby, the Company issued to the Lender an additional 1,200,000 Series G warrants dated September 14, 2020 to purchase an aggregate of 1,200,000 shares of common stock. The original Series G warrants were valued using the relative fair value basis and the amount was recorded as part of the debt issuance costs, see Note 8 for additional details.

On September 14, 2020, the Company and the Lender entered into an amendment to the credit agreement that increased the amount available under delayed draw term loans by $2.0 million. The Company borrowed $1.0 million of the available amount immediately and the remaining $1.0 million will be available in increments of least $500 thousand with at least 30 days between borrowings and issued an additional 1,200,000 Series G Warrants. The Company evaluated the accounting related to the amendment and in conjunction with the warrants issued. Based on this analysis the Company determined the agreements are substantially different and extinguished the original credit agreement and recorded the amended credit agreement as a new debt at a fair value of $3.9 million. As a result in 2020, the Company recorded a debt discount of approximately $0.6 million and a $2.4 million loss on extinguishment of debt which is comprised of the fair value of the warrants and unamortized debt issuance cost with the original credit agreement, offset by the debt discount. Pursuant to the amendment of the credit agreement, the maturity date of the loans was March 31, 2021 and the loans bear interest at LIBOR plus 2.5%.

On December 16, 2020, the Company and the Lender entered into the third amendment to the credit agreement that increased the amount available under delayed draw term loans by an additional $4.0 million. The Company borrowed the entire $4.0 million of the available amount immediately and issued an additional 4,000,000 Series G Warrants. The Company evaluated the accounting related to the amendment and in conjunction with the warrants issued. Based on this analysis the Company determined the agreements are substantially different and extinguished the original credit agreement and recorded the amended credit agreement as a new debt at a fair value of $8.9 million. As a result in 2020, the Company recorded a debt discount of approximately $0.6 million and a $5.3 million loss on extinguishment of debt which is comprised of the fair value of the warrants and unamortized debt discount cost with the original credit agreement, offset by the debt discount related to the new debt. At December 31, 2020 there was approximately $0.5 million of unamortized debt discount. Pursuant to the amendment of the credit agreement, the maturity date of the loan was March 31, 2021 and the loans bear interest at LIBOR plus 2.5%.

On January 19, 2021, the Company and the Lender entered into an amendment to the credit agreement that increased the amount available under delayed draw term loans by $1.0 million, which was used to fund the $1.0 million escrow fund securing the termination fee under the Merger Agreement and issued an additional 1,000,000 Series G Warrants. The Company evaluated the accounting related to the amendment and in conjunction with the warrants issued. Based on this analysis the Company determined the agreements are substantially different and extinguished the original credit agreement and recorded the amended credit agreement as a new debt at a fair value of $10.0 million. As a result, during the three months ended March 31, 2021, the Company recorded a debt discount of approximately $0.5 million and a $3.0 million loss on extinguishment of debt, which is comprised of the fair value of the warrants and unamortized debt issuance cost with the original credit agreement, offset by the debt discount. At March 31, 2021, there was approximately $0.1 million of unamortized debt discount. Pursuant to the amendment of the credit agreement, the maturity date of the loans are March 31, 2021 and the loans bear interest at LIBOR plus 2.5%.

On March 10, 2021, the Company and the Lender entered into an amendment to the credit agreement that extended the maturity date from March 31, 2021 to March 31, 2022. The Company has accounted for this amendment as a debt modification. The associated unamortized debt discount on the January 19, 2021 amendment of $0.1 million, will be amortized as interest expense over the term of the amended credit agreement.

Asset Purchase Consideration Payable

The asset purchase consideration payable related to the Company's December 2018 acquisition of the LAP-BAND product line from Apollo Endosurgery, Inc. ("Apollo"), was initially recorded at net present value using a discount rate of 5.1%. The asset purchase consideration payable was originally secured by a first security interest in substantially all of the Company's assets, but that security interest terminated in accordance with its terms in October 2019. At March 31,

2021, the aggregate carrying value of the current asset purchase consideration payable of approximately $2.9 million, as adjusted for accretion of interest of approximately $0.6 million.

(6) Leases

The Company has a noncancelable operating lease for office and warehouse space in San Clemente, California and noncancelable operating leases for certain office equipment that expire at various dates through 2022. The Company does not have any short-term leases or financing lease arrangements and the effects of any lease modifications have not been material. Certain of the Company's equipment leases include variable lease payments that are adjusted periodically based on actual usage. Lease and non-lease components are accounted for separately.

Operating lease costs was $0.1 million for both the three months ended March 31, 2021 and 2022. Variable lease costs were not material.

Supplemental information related to operating leases is as follows:

Balance Sheet Information at March 31, 2021		
Operating lease ROU assets	$	390
Operating lease liabilities, current portion	$	320
Operating lease liabilities, long-term portion		82
Total operating lease liabilities	$	402
Cash Flow Information for the Three Months Ended March 31, 2021		
Cash paid for amounts included in the measurement of operating leases liabilities	$	81

Maturities of operating lease liabilities were as follows:

Twelve months ending March 31,		
2022	$	333
2023		83
2024		—
Total lease payments		416
Less: imputed interest		14
Total lease liabilities	$	402
Weighted-average remaining lease term at end of period (in years)		1.2
Weighted-average discount rate at end of period		5.1

(7) Equity

December 2020 Exercise of Warrants for Common Stock

On December 3, 2020, the Company issued 290,000 shares of common stock to two healthcare focused institutional investors, totaling 580,000 shares of common stock, as an exercise of pre-funded warrants issued in connection with the June 2019 and September 2019 private placement transactions. The Company received approximately $0.1 million in connection with these exercises.

June 2020 Cashless Exercise of Warrants for Common Stock

On June 23, 2020, the Company issued 58,981 shares of common stock as a cashless exercise of warrants issued to the placement agents in connection with the June 2019 private placement with healthcare focused institutional investors.

May 2020 Common Stock Issued for Professional Services

On May 28, 2020, the Company issued 50,000 shares of common stock, having an aggregate fair value of $0.2 million for ongoing professional services. The $0.2 million was recorded as a prepaid asset and will be amortized over the minimum life of the agreement.

April 2020 Exercise of Warrants for Common Stock

As discussed in Note 5 above, in connection with the credit agreement, the lender exercised its Series C and Series F warrants to purchase an aggregate of 5,085,834 shares of common stock with a current exercise price of $0.12 per warrant on April 15, 2020, in which the Company received net proceeds of $0.6 million.

(8) Warrants

On January 19, 2021, the Company issued 1,000,000 Series G Warrants to an institutional investor in connection with an amendment to the credit agreement. The Series G Warrants were valued at $3.0 million using the fair value approach at the time of issuance and was recorded as a component of the loss on extinguishment of debt during the three months ended March 31, 2021, see Note 5 above for details. The fair value of the Series G Warrants was determined using a Black Scholes option pricing model using a risk free rate of 0.45%, an expected term of five years; expected dividends of zero and expected volatility of 97.1%.

On December 16, 2020, the Company issued 4,000,000 Series G Warrants to an institutional investor in connection with an amendment to the credit agreement. The Series G Warrants were valued at $5.6 million using the fair value approach at the time of issuance and was recorded as a component of the loss on extinguishment of debt in 2020, see Note 5 above for details. The fair value of the Series G Warrants was determined using a Black Scholes option pricing model using a risk free rate of 0.37%, an expected term of five years; expected dividends of zero and expected volatility of 100.8%.

On September 14, 2020, the Company issued 1,200,000 Series G Warrants to an institutional investor in connection with an amendment to the credit agreement. The Series G Warrants were valued at $2.9 million using the fair value approach at the time of issuance and was recorded as a component of the loss on extinguishment of debt in 2020, see Note 5 above for details. The fair value of the Series G Warrants was determined using a Black Scholes option pricing model using a risk-free interest rate of 0.27%, an expected term of five years; expected dividends of zero and expected volatility of 101.1%.

On March 25, 2020, the Company issued 1,200,000 Series G Warrants to an institutional investor in connection with the credit agreement, see Note 5 above for details. The Series G Warrants were valued at $1.4 million using the relative fair value approach at the time of issuance and was recorded as deferred debt issuance cost in 2020. The relative fair value of the Series G Warrants was determined using a Black Scholes option pricing model using a risk-free interest rate of 0.56%; an expected term of five years; expected dividends of zero and expected volatility of 97.00%.

(9) Revenue Disaggregation and Operating Segments

The Company conducts operations worldwide and has sales in the following regions: United States, Australia, Europe and Rest of World. For the three months ended March 31, 2021 and 2020, the Company primarily only sold the LAP-BAND product line. The following table presents the Company's revenue disaggregated by geography:

	Three Months Ended March 31,	
	2021	2020
United States	$ 2,520	$ 1,954
Australia	293	298
Europe	379	537
Rest of world	29	—
Total net revenue	$ 3,221	$ 2,789

*The next largest individual country outside the United States was Australia for the three months ended March 31, 2021 and 2020 which was 9.1% and 10.7%, respectively, of total revenues.

Operating Segments

The Company conducts operations worldwide and is managed in the following geographical regions: United States, Australia, Europe and the Rest of World (primarily in The Middle East). All regions sell the LAP-BAND product line, which consisted of nearly all our revenue and gross profit for the three months ended March 31, 2021 and 2020. During the second half of 2020 the Company launched reshape**care**, which had minimal revenue for the three months ended March 31, 2021 and no revenue for the three months ended March 31, 2020. The Company anticipates generating more reshape**care** revenue late in the second quarter and in to the second half of the year. There was no revenue or gross profit recorded for the ReShape Vest or Diabetes Bloc-Stim Neuromodulation for the three months ended March 31, 2021 and 2020 as these two products are still in the development stage.

(10) Income Taxes

The Company's tax provision for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items arising in that quarter. In each quarter the Company updates its estimate of the annual effective tax rate. The Company's quarter tax provision, and quarterly estimate of annual effective tax rate, are subject to significant volatility due to several factors, including the Company's ability to accurately predict pre-tax income and loss. During the three months ended March 31, 2021, a $25 thousand tax expense was recorded, primarily due to projected income in Australia and Netherlands. During the three months ended March 31, 2020, an $18 thousand tax benefit was recorded, due to the valuation allowance on deferred tax assets.

In assessing the realization of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Based on the level of historical losses, projections of losses in future periods and potential limitations pursuant to changes in ownership under Internal Revenue Code ("IRC") Section 382, the Company provided a valuation allowance at both March 31, 2021 and December 31, 2020.

(11) Stock-based Compensation

Stock-based compensation expense related to stock options issued under the ReShape Lifesciences Inc. Second Amended and Restated 2003 Stock Incentive Plan (the "Plan") and as inducement grants for the three months ended March 31, 2021 and 2020 were as follows:

	Three Months Ended March 31,	
	2021	2020
General and administrative	$ 101	$ 427
Total stock-based compensation expense	$ 101	$ 427

As of March 31, 2021, there was approximately $0.1 million of total unrecognized compensation costs related to unvested stock option awards, which are to be recognized over a weighted-average period of 0.9 years. There were no stock options granted during both the three months ended March 31, 2021 and 2020.

(12) Commitments and Contingencies

Litigation

The Company is not currently a party to any material litigation and the Company is not aware of any pending or threatened litigation against it that could have a material adverse effect on the Company's business, operating results or financial condition. The medical device industry in which the Company operates is characterized by frequent claims and litigations, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, the Company may be involved in various legal proceedings from time to time.

Product Liability Claims

The Company is exposed to product liability claims that are inherent in the testing, production, marketing and sale of medical devices. Management believes any losses that may occur from these matters are adequately covered by insurance, and the ultimate outcome of these matters will not have a material effect on the Company's financial position or results of operations. The Company is not currently a party to any product liability litigation and is not aware of any pending or threatened product liability litigation that is reasonably possible to have a material adverse effect on the Company's business, operating results or financial condition.

(13) Subsequent Events and Merger

On January 19, 2021, the Company entered into an agreement and plan of merger with Obalon Therapeutics, Inc., a Delaware corporation ("Obalon") and Optimus Merger Sub, Inc., a Delaware corporation and wholly-owned subsidiary of Obalon ("Merger Sub"), pursuant to which Merger Sub will merge with and into ReShape as the surviving corporation and a wholly-owned subsidiary of Obalon (the "Merger"). As a result of the Merger, Obalon will be renamed "ReShape Lifesciences Inc."

Subject to the terms and conditions of the Merger Agreement, at the closing of the Merger, each outstanding share of ReShape common stock and series B convertible preferred stock will be converted into the right to receive shares of common stock of Obalon ("Obalon Shares") based on the exchange ratio set forth in the Merger Agreement. Upon completion of the Merger, ReShape stockholders will own approximately 51% of the combined company's outstanding common stock and Obalon stockholders will own approximately 49%, subject to the terms of the Merger Agreement. Obalon will, at the effective time of the Merger, assume the outstanding warrants and series C convertible preferred stock of ReShape, subject to the terms of the Merger Agreement. All outstanding stock options of ReShape will be cancelled and terminated at the effective time of the Merger without any right to receive any consideration. No fractional shares will be issued in connection with the Merger and Obalon will pay cash in lieu of any such fractional shares. The Merger is intended to qualify for federal income tax purposes as a tax-free reorganization under the provisions of Section 368(a) of the Internal Revenue Code of 1986, as amended.

Consummation of the Merger is subject to certain closing conditions, including, among other things, approval by the stockholders of ReShape and Obalon and the NASDAQ Stock Market's approval of (i) the Listing of Additional Shares Notice covering the Obalon Shares to be issued in the Merger and (ii) the continued listing of the combined company following completion of the Merger ((i) and (ii) together, the "NASDAQ Approvals"). Pursuant to the Merger Agreement, ReShape has agreed to exercise its reasonable best efforts to take all necessary steps to obtain the NASDAQ Approvals following the execution of the Merger Agreement, which may include procuring additional equity or debt investments, financings or other capital raising efforts. The Merger Agreement contains specified termination rights for both ReShape and Obalon. If Obalon terminates the Merger Agreement as a result of ReShape's breach of its covenant to use its reasonable best efforts to obtain the NASDAQ Approvals, or if either party terminates the Merger Agreement because the NASDAQ Approvals have not been obtained within 30 days following the later of the Obalon Stockholders' Meeting and the ReShape Stockholders' Meeting, then ReShape will be required to pay Obalon a $1.0 million termination fee, which has been deposited with a third-party escrow agent.

At the effective time of the Merger, the Board of Directors of the combined company is expected to consist of the five current members of the Board of Directors of ReShape, and the executive officers of the combined company will be the current executive officers of ReShape

In addition, under the terms of the Merger Agreement, Obalon has agreed to file with NASDAQ a Listing of Additional Shares Notice covering the Obalon shares to be issued in connection with the Merger on the NASDAQ Stock Market and to seek approval of NASDAQ to change its name to ReShape Lifesciences Inc. and its trading symbol for its shares of common stock to "RSLS" upon the effective time of the Merger.

The Merger Agreement contains customary representations, warranties and covenants by ReShape and Obalon. ReShape and Obalon have agreed, among other things, subject to certain exceptions, not to (1) directly or indirectly initiate, seek, or solicit, or knowingly encourage or facilitate any offer or alternative proposal for specified alternative transactions, or (2) participate or engage in discussions or negotiations regarding such an offer or proposal with, or furnish any nonpublic information regarding such an offer or proposal to, any person that has made or, to ReShape's or Obalon's knowledge, is considering making such an offer or proposal, (3) terminate, amend, modify, or waive any standstill or similar obligation (subject to certain conditions), or (4) enter into any agreement with respect to an alternative proposal. In addition, certain covenants require each of the parties to use, subject to the terms and conditions of the Merger Agreement, their commercially reasonable efforts to cause the Merger to be consummated as promptly as practicable. Subject to certain exceptions, the Merger Agreement also requires each of ReShape and Obalon to call and hold stockholders' meetings and requires the board of directors of each of ReShape and Obalon to recommend approval of the Merger.

On April 13, 2021, the Company filed with the SEC the Definitive Proxy Statement regarding the merger proposal with Obalon. The Company held a Special Stockholders Meeting on May 13, 2021, in which the shareholders of the Company approved the merger. Obalon concurrently held a Special stockholders Meeting on May 13, 2021. To achieve a quorum for Obalon's Special Meeting, a majority of voting power must be present or represented by proxy and as of May 13, 2021, approximately 45.5% of such shares were present or represented and approximately 96% had voted in for of the proposals. In the absence of quorum and votes necessary to approve the proposals in connection with the Merger, Obalon adjourned the meeting until May 25, 2021 in order to solicit additional votes.

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

Except for the historical information contained herein, the matters discussed in this "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements that involve risks and uncertainties. In some cases, these statements may be identified by terminology such as "may," "will," "should," "expects," "could," "intends," "might," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue," or the negative of such terms and other comparable terminology. These statements involve known and unknown risks and uncertainties that may cause our results, level of activity, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that may cause or contribute to such differences include, among others, those discussed in the "Risk Factors" section included in Item 1A of our Annual Report on Form 10-K filed on March 11, 2021.

Except as may be required by law, we undertake no obligation to update any forward-looking statement to reflect events after the date of this report.

Overview

We are the premier global weight-loss solutions company, offering an integrated portfolio of proven products and services that manage and treat obesity and associated metabolic disease. Our primary operations are in the following geographical areas: United States, Australia and certain European and Middle Eastern countries. Our current portfolio includes the LAP-BAND Adjustable Gastric Banding System, reshape**care** virtual health coaching program, the ReShape Vest an investigational device to help treat more patients with obesity, and the Diabetes Bloc-Stim Neuromodulation device, a technology under development as a new treatment for type 2 diabetes mellitus. There has been no revenue recorded for the ReShape Vest or the Diabetes Bloc-Stim Neuromodulation as these products are still in the development stage.

Recent Developments

On January 19, 2021, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Obalon Therapeutics, Inc., a Delaware corporation (“Obalon”), and Optimus Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of Obalon (“Merger Sub”), pursuant to which Merger Sub will merge with and into ReShape, with ReShape as the surviving corporation and a wholly-owned subsidiary of Obalon (the “Merger”). As a result of the Merger, Obalon will be renamed “ReShape Lifesciences Inc.”

On January 19, 2021, concurrently with the execution of the Merger Agreement, ReShape entered into a Credit Facility Agreement (“Credit Facility Agreement”) with Armistice, which is ReShape’s existing secured lender and majority stockholder, pursuant to which Armistice agreed to provide ReShape with a $15.0 million line of credit that ReShape may access from time to time until December 31, 2022. ReShape has not drawn down any amounts under the Credit Facility Agreement. Any advances will bear interest at a rate per annum equal to the LIBOR rate plus 2.5%, and would be subject to the Guarantee and Collateral Agreement between ReShape and Armistice dated March 25, 2020.

On January 19, 2021, the Company entered into the fourth amendment to the credit agreement that increased the amount available under the delayed draw term loans by $1.0 million, of which all funds were received upfront and used for the escrow fund securing the termination fee under the Merger Agreement. The maturity date of the loans under the credit agreement, including those under the amendment was March 31, 2021.

On March 1, 2021, the Company received confirmation from the SBA that the PPP Loan was forgiven in full including all interest incurred.

On March 10, 2021, the Company entered into the fifth amendment to the credit agreement that extended the maturity date from March 31, 2021 to March 31, 2022.

On April 13, 2021, the Company filed with the SEC the Definitive Proxy Statement regarding the merger proposal with Obalon. The Company held a Special Stockholders Meeting on May 13, 2021, in which the shareholders of the Company approved the merger. Obalon concurrently held a Special stockholders Meeting on May 13, 2021. To achieve a quorum for Obalon's Special Meeting, a majority of voting power must be present or represented by proxy and as of May 13, 2021, approximately 45.5% of such shares were present or represented and approximately 96% had voted in for of the proposals. In the absence of quorum and votes necessary to approve the proposals in connection with the Merger, Obalon adjourned the meeting until May 25, 2021 in order to solicit additional votes.

Results of Operations

The following table sets forth certain data from our unaudited consolidated statements of operations expressed as percentages of net revenue (in thousands):

	Three Months Ended March 31,			
	2021		2020	
Revenue	$ 3,221	100.0 %	$ 2,789	100.0 %
Cost of goods sold	937	29.1 %	1,285	46.1 %
Gross profit	2,284	70.9 %	1,504	53.9 %
Operating expenses:				
Sales and marketing	1,250	38.8 %	1,454	52.1 %
General and administrative	2,720	84.4 %	2,836	101.7 %
Research and development	571	17.7 %	1,295	46.4 %
Total operating expenses	4,541	141.0 %	5,585	200.3 %
Operating loss	(2,257)	(70.1)%	(4,081)	(146.3)%
Other expense (income), net:				
Interest expense, net	599	18.6 %	104	3.7 %
Loss on extinguishment of debt, net	1,960	60.9 %	—	— %
Loss on foreign currency	33	1.0 %	144	5 %
Loss before income tax provision	(4,849)	(150.5)%	(4,329)	(155.2)%
Income tax expense (benefit)	25	0.8 %	(18)	(1)%
Net loss	$ (4,874)	(151.3)%	$ (4,311)	(154.6)%

Non-GAAP Disclosures

In addition to the financial information prepared in conformity with GAAP, we provide certain historical non-GAAP financial information. Management believes that these non-GAAP financial measures assist investors in making comparisons of period-to-period operating results and that, in some respects, these non-GAAP financial measures are more indicative of the Company's ongoing core operating performance than their GAAP equivalents.

Management believes that the presentation of this non-GAAP financial information provides investors with greater transparency and facilitates comparison of operating results across a broad spectrum of companies with varying capital structures, compensation strategies, derivative instruments, and amortization methods, which provides a more complete understanding of our financial performance, competitive position, and prospects for the future. However, the non-GAAP financial measures presented in the Form 10-Q have certain limitations in that they do not reflect all of the costs associated with the operations of our business as determined in accordance with GAAP. Therefore, investors should consider non-GAAP financial measures in addition to, and not a substitute for, or as superior to, measures of financial performance prepared in accordance with GAAP. Further, the non-GAAP financial measures presented by the Company may be different from similarly named non-GAAP financial measures used by other companies.

Adjusted EBITDA

Management uses adjusted EBITDA in its evaluation of the Company's core results of operations and trends between fiscal periods and believes that these measures are important components of its internal performance measurement process. Adjusted EBITDA is defined as net loss before interest, taxes, depreciation and amortization, stock-based compensation, and other one-time costs.

The following table contains a reconciliation of non-GAAP net loss to GAAP net loss attributable to common stockholders for the three months ended March 31, 2021 and 2020 (in thousands):

	Three Months Ended March 31,	
	2021	2020
GAAP net loss	$ (4,874)	$ (4,311)
Adjustments:		
Interest expense, net	599	104
Income tax expense (benefit)	25	(18)
Depreciation and amortization	418	421
Stock-based compensation expense	101	427
Loss on extinguishment of debt, net	1,960	—
Non-GAAP loss	$ (1,771)	$ (3,377)

Comparison of Results of Operations

Three months ended March 31, 2021 and March 31, 2020

Net Revenue: The following table summarizes our unaudited net revenue by geographic location based on the location of customers for the three months ended March 31, 2021 and 2020, as well as the percentage of each location to total revenue and the amount of change and percentage of change (dollars in thousands):

	Three Months Ended March 31,				Amount	Percentage
	2021		2020		Change	Change
United States	$ 2,520	78.2 %	$ 1,954	70.1 %	$ 566	29.0 %
Australia	293	9.1 %	298	10.7 %	(5)	(1.7)%
Europe	379	11.8 %	537	19 %	(158)	(29.4)%
Rest of World	29	0.9 %	-	— %	29	100.0 %
Total net revenue	$ 3,221	100.0 %	$ 2,789	100.0 %	$ 432	15.5 %

Revenue totaled $3.2 million for the three months ended March 31, 2021, compared to $2.8 million for the same period in 2020. The primary reason for the increase in revenue of $0.4 million, or 15.5%, is due to a $0.6 million increase in sales for the United States, offset by a $0.2 million decrease internationally. Although the COVID 19 pandemic restrictions began to lessen for elective surgeries domestically, there were still several regions that were heavily effected internationally.

Cost of Goods Sold and Gross Profit: The following table summarizes our unaudited cost of revenue and gross profit for the three months ended March 31, 2021 and 2020, as well as the percentage compared to total revenue and amount of change and percentage of change (dollars in thousands):

	Three Months Ended March 31,				Amount	Percentage
	2021		2020		Change	Change
Revenue	$ 3,221	100.0 %	$ 2,789	100.0 %	$ 432	15.5 %
Cost of goods sold	937	29.1 %	1,285	46.1 %	(348)	(27.1)%
Gross profit	$ 2,284	70.9 %	$ 1,504	53.9 %	$ 780	51.9 %

Gross Profit. Gross profit for the three months ended March 31, 2021 was $2.3 million compared to $1.5 million for the same period in 2020, an increase of $0.8 million. Gross profit as a percentage of total revenue for the three months ended March 31, 2021 was 70.9% compared to 53.9% for the same period in 2020. The increase in gross profit margin is primarily due to increased volume, as revenue increased 15.5%, lower overhead department expenses, and improved product mix with higher domestic sales, which have a higher gross profit margin than international sales.

Operating Expenses: The following table summarizes our unaudited operating expenses for the three months ended March 31, 2021 and 2020, as well as the percentage of total revenue and the amount of change and percentage of change (dollars in thousands):

	Three Months Ended March 31,				Amount	Percentage
	2021		2020		Change	Change
Sales and marketing	$ 1,250	38.8 %	$ 1,454	52.1 %	$ (204)	(14.0)%
General and administrative	2,720	84.5 %	2,836	101.7 %	(116)	(4.1)%
Research and development	571	17.7 %	1,295	46.5 %	(724)	(55.9)%
Total operating expenses	$ 4,541	141.0 %	$ 5,585	200.3 %	$ (1,044)	(18.7)%

Sales and Marketing Expense. Sales and marketing expenses for the three months ended March 31, 2021 decreased by $0.2 million, or 14.0%, to $1.3 million, compared to $1.5 million for the same period in 2020. The decrease is mainly due to a decrease in payroll related expenses of $0.2 million, primarily a result of the Employee Retention Credit received as a part of the CARES Act, and a reduction in consulting fees of $0.1 million. This was offset by an increase of $0.1 million in advertising and marketing expenditures as the Company expects to focus more efforts on advertising and marketing for 2021.

General and Administrative Expense. General and administrative expenses for the three months ended March 31, 2021 decreased by $0.1 million, or 4.4%, to $2.7 million, compared to $2.8 million for the same period in 2020. The decrease is primarily due to decreases in stock-based compensation expense of $0.3 million from lack of stock option grants, $0.1 million in bad debt expense on improved collections, and $0.1 million in travel and entertainment expenses from reduced travel during the COVID 19 pandemic. This was offset by an increase in audit, consulting, legal and professional services of $0.4 million primarily related to the proposed merger with Obalon.

Research and Development Expense. Research and development expenses for the three months ended March 31, 2021 decreased by $0.7 million, or 55.9%, to $0.6 million, compared to $1.3 million for the same period in 2020. The decrease is primarily a result of a slowdown in clinical trials for the ReShape Vest due to the COVID 19 pandemic.

Net Interest Expense. Net interest expense for the three months ended March 31, 2021 increased $0.5 million to $0.6 million compared to $0.1 million for the same period in 2020. The primary reason for the increase is due to the amortization of debt discount recorded as interest expense, related to the credit agreement with an institutional investor.

Loss on Extinguishment of Debt, Net. Loss on extinguishment of debt, net for the three months ended March 31 2021 was $2.0 million, which consisted of $3.0 million related to the fair value of the warrants issued in connection with the January 19, 2021 credit agreement amendments. This was offset by a $1.0 million gain on the full extinguishment of our PPP loan, as we received official confirmation of forgiveness on March 1, 2021.

Income Tax Expense (Benefit). An income tax expense of $25 thousand was recorded for the three months ended March 31, 2021, primarily related to projected income in Australia and Netherlands, compared to a benefit of $18 thousand for the three months ended March 31, 2020.

Liquidity and Capital Resources

We have financed our operations to date principally through the sale of equity securities and debt financings. During the three months ended March 31, 2021 and 2020, we received proceeds of $1.0 million and $2.5 million, respectively, from the credit agreement with an institutional investor. As of March 31, 2021, we had $1.9 million of cash and cash equivalents, including $1.1 million of restricted cash. During March of 2021, the Company received confirmation from the SBA that the PPP Loan was forgiven in full including all interest incurred.

In January 2021, we successfully obtained a $15.0 million line of credit with an institutional investor, and entered into an agreement to merge with Obalon resulting in the removal of the going concern opinion. The Company anticipates this will result in the combined company’s common stock being traded on the NASDAQ Capital Market. Obalon is currently traded on the NASDAQ Stock Exchange under the ticker OBLN. As of March 31, 2021, the Company has not made a draw on this Credit Facility.

The Company is also pursuing further funding options, including seeking additional equity or debt financing to support the expansion of the LAP-BAND product line, the introduction of reshape**care** to the market place; and the continued development and successful commercialization of the ReShape Vest and the ReShape Diabetes Bloc-Stim Neuromodulation.

The following table summarizes our change in cash and cash equivalents and restricted cash (in thousands):

	Three Months Ended March 31,	
	2021	2020
Net cash used in operating activities	$ (1,961)	$ (3,245)
Net cash used in investing activates	(119)	—
Net cash provided in financing activities	1,000	2,475
Effect of exchange rate changes	19	(48)
Net change in cash and cash equivalents	$ (1,061)	$ (818)

Net Cash Used in Operating Activities

Net cash used in operating activities from continuing operations was $2.0 million and $3.2 million for the three months ended March 31, 2021 and 2020, respectively. For the three months ended March 31, 2021, net cash used in operating activities was primarily the result of our net loss of $4.9 million, partially offset by non-cash adjustments for amortization of intangible assets of $0.4 million, net loss on extinguishment of debt of $2.0 million, stock-based compensation expense of $0.1 million, and amortization of debt discount of $0.5 million. In addition, we had an increase in sales that resulted in a cash inflow related to inventory of $0.2 million. We also had a positive cash effect due to prepayments made late in 2020 of $0.2 million, as well as a positive cash effect related to accounts payable and accrued liabilities of $0.3 million. This was offset by a $0.8 million negative cash effect from increased accounts receivable primarily attributable to late sales during the first quarter.

Net Cash Used in Investing Activities

Net cash used in investing activities for the three months ended March 31, 2021 was $0.1 million, comprised of capital expenditures related to the process of moving manufacturing from Costa Rica to the United States, and product development.

There was no cash used in investing activities for the three months ended March 31, 2020.

Net Cash Provided by Financing Activities

Net cash provided by financing activities was $1.0 million for the three months ended March 31, 2021, due to $1.0 million received from the credit agreement with an institutional investor.

Net cash provided by financing activities of $2.5 million for the three months ended March 31, 2020, consisted of proceeds received from the credit agreement with an institutional investor.

Operating Capital and Capital Expenditure Requirements

Our anticipated operations include plans to (i) integrate the sales and operations of the Company with the LAPBAND product line in order to expand sales domestically and internationally as well as to obtain cost savings synergies, (ii) introduce to the market place reshape**care**, (iii) continue clinical test of the ReShape Vest, (iv) continue development of the Diabetes Bloc-Stim Neuromodulation, (v) seek opportunities to leverage our intellectual property portfolio and custom development services to provide third-party sales and licensing opportunities, and (vi) explore and capitalize on synergistic opportunities to expand our portfolio and offer future minimally invasive treatments and therapies in the obesity continuum of care. The Company believes that it has the flexibility to manage the growth of its expenditures and operations depending on the amount of available cash flows, which could include reducing expenditures for marketing, clinical and product development activities.

Obtaining funds through the sale of additional equity and debt securities or the warrant holders' exercise of outstanding common stock warrants may result in dilution to our stockholders. If we raise additional funds through the issuance of debt securities, these securities could have rights senior to those of our common stock and could contain covenants that would restrict our operations. The sale of additional equity may require us to obtain approval from our stockholders to increase the number of shares of common stock we have authorized under our certificate of incorporation. We may require additional capital beyond our currently forecasted amounts. Any such required additional capital may not be available on reasonable terms, if at all. If we are unable to obtain additional financing, we may be required to reduce the scope of, delay, or eliminate some or all of, our planned research, development and commercialization activities, which could materially harm our business. In addition, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to products or proprietary technologies, or grant licenses on terms that are not favorable.

Our forecast of the period of time through which our financial resources will be adequate to support our operations, the costs to complete development of products and the cost to commercialize our products are forward-looking statements and involve risks and uncertainties, and actual results could vary materially and negatively as a result of a number of factors, including the factors discussed in Part I, Item 1A, "*Risk Factors*", of our Annual Report on Form 10-K. We have based these estimates on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect.

Because of the numerous risks and uncertainties associated with the development of medical devices, such as our ReShape Vest and Diabetes Bloc-Stim Neuromodulation, we are unable to estimate the exact amounts of capital outlays and operating expenditures necessary to complete the development of the ReShape Vest and Diabetes Bloc-Stim Neuromodulation or other additional products and successfully deliver a commercial product to the market. Our future capital requirements will depend on many factors, including, but not limited to, the following:

- the cost and timing of establishing sales, marketing and distribution capabilities;
- the cost of establishing clinical and commercial supplies of our ReShape Vest and Diabetes Bloc-Stim Neuromodulation, and any products that we may develop;
- the rate of market acceptance of our ReShape Vest and Diabetes Bloc-Stim Neuromodulation and any other product candidates;
- the cost of filing and prosecuting patent applications and defending and enforcing our patent and other intellectual property rights;
- the cost of defending, in litigation or otherwise, any claims that we infringe third-party patent or other intellectual property rights;
- the effect of competing products and market developments;
- the cost of explanting clinical devices;
- the terms and timing of any collaborative, licensing or other arrangements that we may establish;
- any revenue generated by sales of our LAP-BAND, reshape**care**, ReShape Vest, Diabetes Bloc-Stim Neuromodulation or future products;
- the scope, rate of progress, results and cost of our clinical trials and other research and development activities;
- the cost and timing of obtaining any further required regulatory approvals; and

- the extent to which we invest in products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

Critical Accounting Policies and Estimates

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. Information with respect to our critical accounting policies and estimates which we believe could have the most significant effect on our reported results and require subjective or complex judgments by management is contained on pages 37-38 in Item 7, "*Management's Discussion and Analysis of Financial Condition and Results of Operations*," of our Annual Report on Form 10-K for the year ended December 31, 2020. There have been no significant changes from the information discussed therein.

During the three months ended March 31, 2021 there were no material changes to our significant accounting policies which are fully described in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2020.

Off-Balance Sheet Arrangements

As of March 31, 2021, we did not have any off-balance sheet arrangements.

Recent Accounting Pronouncements

See Note 1 to our condensed consolidated financial statements for a discussion of recent accounting pronouncements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide disclosure pursuant to this item.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), defines the term "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is 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 the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Based on their evaluation as of March 31, 2021, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are designed at a reasonable level and effective as of the end of the period covered in the report in providing reasonable assurance that the information we are required to disclose in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting during the quarter ended March 31, 2021 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not currently a party to any litigation and the Company is not aware of any pending or threatened litigation against it that reasonably likely to have a material adverse effect on the Company's business, operating results or financial condition. The medical device industry in which the Company operates is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, the Company may be involved in various legal proceedings from time to time.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors set forth in Item 1A. "*Risk Factors*" of our 2020 Annual Report on Form 10-K filed on March 11, 2021.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Unregistered Sales of Equity Securities

None.

Uses of Proceeds from Sale of Registered Securities

None.

Purchases of Equity Securities

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit No.	Description
10.1	Fifth Amendment to Credit Agreement, dated March 10, 2021, by and between the Company and Armistice Capital Master Fund Ltd.
10.2	Series G Common Stock Purchase Warrant, dated September 14, 2020, issued by the Company to Armistice Capital Master Fund Ltd. (incorporated by reference to exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 15, 2020 (File No. 001-33818)).
31.1**	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to 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**	Financial statements from the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2021, formatted in Extensible Business Reporting Language: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Stockholders' Equity, (iv) the Condensed Consolidated Statements of Cash Flows and (v) the Notes to Condensed Consolidated Financial Statements.

** Filed 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.

RESHAPE LIFESCIENCES INC.

BY: /S/ BARTON P. BANDY
Barton P. Bandy
President and Chief Executive Officer
(principal executive officer)

BY: /S/ THOMAS STANKOVICH
Thomas Stankovich
Senior Vice President and
Chief Financial Officer
(principal financial and accounting officer)

Dated: May 17, 2021

Exhibit 31.1

CERTIFICATION

I, Barton P. Bandy, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ReShape Lifesciences 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 consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ BARTON P. BANDY
Barton P. Bandy
President and Chief Executive Officer

Date: May 17, 2021

Exhibit 31.2

CERTIFICATION

I, Thomas Stankovich certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of ReShape Lifesciences 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 consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THOMAS STANKOVICH
Thomas Stankovich
Chief Financial Officer, Senior Vice President, Finance

Date: May 17, 2021

Exhibit 32.1

CERTIFICATION

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Barton P. Bandy, in his capacity as Chief Executive Officer of ReShape Lifesciences Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2021 to which this Certification is attached as Exhibit 32.1 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of ReShape Lifesciences Inc. as of, and for, the periods covered by the Report.

By: /s/ BARTON P. BANDY
Barton P. Bandy
President and Chief Executive Officer

Date: May 17, 2021

Exhibit 32.2

CERTIFICATION

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Scott P. Youngstrom, in his capacity as Chief Financial Officer of ReShape Lifesciences Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2021 to which this Certification is attached as Exhibit 32.2 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of ReShape Lifesciences Inc. as of, and for, the periods covered by the Report.

By: /s/ THOMAS STANKOVICH
Thomas Stankovich
Chief Financial Officer, Senior Vice President, Finance

Date: May 17, 2021