Table of Contents

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 June 30, 2016

Commission file number: 1-33818

ENTEROMEDICS INC.
(Exact name of registrant as specified in its charter)

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

2800 Patton Road, St. Paul, Minnesota 55113
(Address of principal executive offices, including zip code)

(651) 634-3003
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	☐	Accelerated Filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting entity)	Smaller Reporting Company	☒

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

As of August 11, 2016, 27,294,917 shares of the registrant's Common Stock were outstanding.

INDEX

PART I – FINANCIAL INFORMATION

PART II – OTHER INFORMATION

Registered Trademarks and Trademark Applications: In the United States we have registered trademarks for VBLOC®, ENTEROMEDICS® and MAESTRO®, each registered with the United States Patent and Trademark Office, and trademark applications for VBLOC POWER TO CHOOSE and VBLOC POWER TO CHOOSE AND DESIGN. In addition, some or all of the marks VBLOC, ENTEROMEDICS, MAESTRO, MAESTRO SYSTEM ORCHESTRATING OBESITY SOLUTIONS, VBLOC POWER TO CHOOSE and VBLOC POWER TO CHOOSE AND DESIGN are the subject of either a trademark registration or application for registration in Australia, Brazil, China, the European Community, India, Kuwait, Mexico, Saudi Arabia, Switzerland and the United Arab Emirates. This Quarterly Report on Form 10-Q contains other trade names and trademarks and service marks of EnteroMedics and of other companies.

PART I – FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ENTEROMEDICS INC.
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,517,041	$ 7,927,240
Accounts receivable	182,527	57,928
Inventory	1,957,821	1,686,324
Prepaid expenses and other current assets	462,080	831,495
Total current assets	14,119,469	10,502,987
Property and equipment, net	259,150	326,296
Other assets	609,069	757,802
Total assets	$ 14,987,688	$ 11,587,085
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of convertible notes payable	$ 6,504,543	$ 717,391
Accounts payable	356,978	172,050
Accrued expenses	3,441,887	3,595,415
Accrued interest payable	—	1,172
Total current liabilities	10,303,408	4,486,028
Convertible notes payable, less current portion (net of discounts of $102,450 and $149,340 at June 30, 2016 and December 31, 2015, respectively)	7,830,458	549,791
Common stock warrant liability	463,422	2,877,817
Total liabilities	18,597,288	7,913,636
Commitments and contingencies (note 5)		
Stockholders' equity:		
Common stock, $0.01 par value; 150,000,000 and 13,333,333 shares authorized at June 30, 2016 and December 31, 2015, respectively; 13,223,069 and 7,163,820 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	132,231	71,638
Additional paid-in capital	286,242,634	281,182,349
Accumulated deficit	(289,984,465)	(277,580,538)
Total stockholders' (deficit) equity	(3,609,600)	3,673,449
Total liabilities and stockholders' equity	$ 14,987,688	$ 11,587,085

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Sales	$ 276,000	$ 79,000	$ 348,000	$ 79,000
Cost of goods sold	155,304	30,763	195,439	30,763
Gross profit	120,696	48,237	152,561	48,237
Operating expenses:				
Selling, general and administrative	5,585,548	4,936,363	11,726,725	9,663,882
Research and development	1,193,607	2,452,787	2,625,988	4,689,393
Total operating expenses	6,779,155	7,389,150	14,352,713	14,353,275
Operating loss	(6,658,459)	(7,340,913)	(14,200,152)	(14,305,038)
Other income (expense):				
Interest income	1,807	422	3,498	1,289
Interest expense	(852,946)	(60,423)	(2,002,240)	(274,969)
Change in value of warrant liability	1,309,099	—	3,088,513	—
Change in value of convertible notes payable	1,208,594	—	709,026	—
Other, net	(3,260)	(2,848)	(2,572)	933
Net loss	$ (4,995,165)	$(7,403,762)	$(12,403,927)	$(14,577,785)
Net loss per share—basic and diluted	$ (0.49)	$ (1.49)	$ (1.37)	$ (2.97)
Shares used to compute basic and diluted net loss per share	**10,297,589**	**4,960,292**	**9,078,837**	**4,904,984**

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net loss	$(4,995,165)	$(7,403,762)	$(12,403,927)	$(14,577,785)
Comprehensive loss	$(4,995,165)	$(7,403,762)	$(12,403,927)	$(14,577,785)

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six months ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(12,403,927)	$(14,577,785)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	78,690	97,357
Stock-based compensation	1,846,612	2,920,785
Amortization of commitment fees, debt issuance costs and original issue discount	995,057	196,691
Change in value of convertible notes payable	(709,026)	—
Change in value of warrant liability	(3,088,513)	—
Change in operating assets and liabilities:		
Accounts receivable	(124,599)	(109,695)
Inventory	(271,497)	(303,919)
Prepaid expenses and other current assets	369,871	83,236
Other assets	(90,754)	(229,319)
Accounts payable	184,928	52,493
Accrued expenses	(51,528)	671,362
Accrued interest payable	775,586	(9,353)
Net cash used in operating activities	(12,489,100)	(11,208,147)
Cash flows from investing activities:		
Purchases of property and equipment	(11,544)	(36,454)
Net cash used in investing activities	(11,544)	(36,454)
Cash flows from financing activities:		
Proceeds from sale of common stock and warrants for purchase of common stock	—	6,651,931
Common stock financing costs	(28,000)	(227,557)
Proceeds from convertible notes payable	17,250,000	—
Repayments on convertible notes payable	(404,762)	—
Repayments on notes payable	—	(2,000,000)
Debt issuance costs	(726,793)	—
Net cash provided by financing activities	16,090,445	4,424,374
Net increase (decrease) in cash and cash equivalents	3,589,801	(6,820,227)
Cash and cash equivalents:		
Beginning of period	7,927,240	11,619,167
End of period	$ 11,517,041	$ 4,798,940
Supplemental disclosure:		
Cash paid for interest	$ 163,152	$ 87,630
Noncash investing and financing activities:		
Conversion of convertible notes and interest payable	$ 3,373,265	$ —

See accompanying notes to condensed consolidated financial statements.

EnteroMedics Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

Description of Business

EnteroMedics Inc. (the Company) develops and sells implantable systems to treat obesity, metabolic diseases and other gastrointestinal disorders. The Company was incorporated in the state of Minnesota on December 19, 2002 and was reincorporated in Delaware on July 22, 2004. The Company is headquartered in St. Paul, Minnesota. In January 2006, the Company established EnteroMedics Europe Sárl, a wholly-owned subsidiary located in Switzerland.

The Company's board of directors and stockholders approved a 1-for-15 reverse split (the Reverse Stock Split) of the Company's outstanding common stock that became effective after trading on January 6, 2016. The Reverse Stock Split did not change the par value of the Company's stock or the number of preferred shares authorized by the Company's Fifth Amended and Restated Certificate of Incorporation. An amendment to the Certificate of Incorporation was also approved in connection with the Reverse Stock Split to increase the number of shares of the Company's common stock authorized for issuance to 150 million shares, effective immediately after the Reverse Stock Split on January 6, 2016. All share and per share amounts have been retroactively adjusted to reflect the Reverse Stock Split for all periods presented.

Risks and Uncertainties

The Company is focused on the design and development of medical devices that use neuroblocking technology to treat obesity, metabolic diseases and other gastrointestinal disorders and currently has approvals to commercially launch the Maestro Rechargeable System in the United States and in Australia, the European Economic Area and other countries that recognize the European CE Mark. The Company has devoted substantially all of its resources to recruiting personnel, developing its product technology, obtaining patents to protect its intellectual property and raising capital, and has recently commenced commercial operations in the United States deriving revenues from its primary business activity in 2015.

The Company's products require approval from the U.S. Food and Drug Administration (FDA) or corresponding foreign regulatory agencies prior to commercial sales. The Company received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the Maestro Rechargeable System, and has begun a controlled commercial launch at select centers in the United States. The Maestro Rechargeable System has also received CE Mark and is listed on the Australian Register of Therapeutic Goods (ARTG).

The medical device industry is characterized by frequent and extensive litigation and administrative proceedings over patent and other intellectual property rights. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often difficult to predict, and the outcome may be uncertain until the court has entered final judgment and all appeals are exhausted. The Company's competitors may assert that its products or the use of the Company's products are covered by U.S. or foreign patents held by them.

The Company's activities are subject to significant risks and uncertainties, including the ability to obtain additional financing, and there can be no assurance that the Company will be successful in obtaining additional financing on favorable terms, or at all. If adequate funds are not available, the Company may have to delay development or commercialization of products or license to third parties the rights to commercialize products or technologies that the Company would otherwise seek to commercialize.

Basis of Presentation

The Company has prepared the accompanying condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. The Company's fiscal year ends on December 31.

The accompanying condensed consolidated financial statements and notes thereto are unaudited. In the opinion of the Company's management, these statements include all adjustments, which are of a normal recurring nature, necessary to present a fair presentation. Interim results are not necessarily indicative of results for a full year. The condensed consolidated balance sheet as of December 31, 2015 was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The information included in this Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All intercompany transactions and accounts have been eliminated in consolidation.

Fair Value of Financial Instruments

Carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued liabilities approximate fair value due to their short maturities. The Company's common stock warrants are required to be reported at fair value and the Company has elected to report its senior amortizing convertible notes at fair value. The fair values of common stock warrants and investments in debt and equity securities, if any, are disclosed in Note 3. The fair value of the Company's senior amortizing convertible notes is disclosed in Notes 3 and 7.

Common Stock Warrant Liability

Common stock warrants that were issued in connection with the July 8, 2015 public offering and the November 9, 2015, January 11, 2016 and May 2, 2016 senior amortizing convertible notes are classified as a liability in the condensed consolidated balance sheets, as the common stock warrants issued provide for certain anti-dilution protections in the event shares of common stock or securities convertible into shares of common stock are issued below the then-existing exercise price. The fair value of these common stock warrants is re-measured at each financial reporting period and immediately before exercise, with any changes in fair value being recognized as a component of other income (expense) in the condensed consolidated statements of operations.

Cash and Cash Equivalents

The Company considers highly liquid investments generally with maturities of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates market value. The Company's cash equivalents are primarily in money market funds and certificates of deposit. The Company deposits its cash and cash equivalents in high-quality credit institutions.

Short-Term Investments

The Company considers all investments with maturities greater than three months and less than one year at the time of purchase as short-term investments and classifies them as either available for sale or held to maturity. The Company also considers certain investments with maturities greater than one year but which are also held for liquidity purposes and are available for sale as short-term investments.

Available-for-sale securities are carried at fair value based on quoted market prices, with the unrealized gains and losses included in other comprehensive income within stockholders' equity in the condensed consolidated balance sheets. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in interest and other income. Interest and dividends on securities classified as available for sale are included in interest income. The cost of securities sold is based on the specific identification method.

Short-term investments in debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income, using the interest method, over the period to maturity. Unrealized losses on held-to-maturity securities reflecting a decline in value determined to be other than temporary are charged to income.

Inventory

The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets.

Property and Equipment, Net

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over their estimated useful lives of five to seven years for furniture and equipment and three to five years for computer hardware and software. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful life or the term of the lease. Upon retirement or sale, the cost and related accumulated depreciation or amortization are removed from the condensed consolidated balance sheets and the resulting gain or loss is reflected in the condensed consolidated statements of operations. Repairs and maintenance are expensed as incurred.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment by comparison of the carrying amounts to future net undiscounted cash flows expected to be generated by such assets when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Should an impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset's fair value or estimates of future discounted cash flows. The Company has not identified any such impairment losses to date.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance for deferred income tax assets is recorded when it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The Company has provided a full valuation allowance against the gross deferred tax assets. The Company's policy is to classify interest and penalties related to income taxes as income tax expense in the condensed consolidated statements of operations.

Medical Device Excise Tax

On January 14, 2015, the Company received FDA approval for vBloc Therapy, delivered via the Maestro Rechargeable System, and starting in the second quarter of 2015 revenues were generated from sales in the United States. As a result, the Company is now required to pay a quarterly Medical Device Tax which is a part of the Affordable Care Act, which imposes a 2.3% excise tax on the sale of certain medical devices by device manufactures, producers or importers. The excise tax was effective on sales of devices made after December 31, 2012. The Company records the Medical Device Tax as an operating expense in the condensed consolidated statements of operations. A moratorium was placed on the Medical Device Tax for 2016 and 2017.

Comprehensive Loss

Comprehensive loss is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investment owners and distributions to owners. There was no difference from reported net loss for the three and six months ended June 30, 2016 and 2015.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, title or risk of loss has passed, the selling price is fixed or determinable and collection is reasonably assured. Products are sold through direct sales or medical device distributors and revenue is recognized upon sale to a bariatric center of excellence or a medical device distributor when no right of return or price protection exists. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped "ex works," in which risk of loss is assumed by the distributor at the shipping point. A provision for returns is recorded only if product sales provide for a right of return. No provision for returns was recorded for the three and six months ended June 30, 2016 and 2015, as the product sales recorded did not provide for rights of return.

Research and Development Expenses

Research and development expenses are charged to expense as incurred. Research and development expenses include, but are not limited to, product development, clinical trial expenses, including supplies, devices, explants and revisions, quality assurance, regulatory expenses, payroll and other personnel expenses, materials and consulting costs.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. Diluted net loss per share is based on the weighted-average common shares outstanding during the period plus dilutive potential common shares calculated using the treasury stock method. Such potentially dilutive shares are excluded when the effect would be to reduce a net loss per share. The Company's potential dilutive shares, which include outstanding common stock options and warrants, have not been included in the computation of diluted net loss per share for all periods as the result would be anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share for the three and six months ended June 30, 2016 and 2015:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net loss	$ (4,995,165)	$(7,403,762)	$(12,403,927)	$(14,577,785)
Denominator for basic and diluted net loss per share:				
Weighted-average common shares outstanding	10,297,589	4,960,292	9,078,837	4,904,984
Net loss per share—basic and diluted	$ (0.49)	$ (1.49)	$ (1.37)	$ (2.97)

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:

	June 30,	
	2016	2015
Stock options outstanding	1,934,796	15,483,514
Warrants to purchase common stock	4,062,571	24,199,705

Recently Issued or Adopted Accounting Standards

In March 2016, the Financial Accounting Standards Board (FASB) issued *Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (Accounting Standards Update No. 2016-09 (ASU 2016-09))*. ASU 2016-09 modifies several aspects of the accounting for share-based payment awards, including income tax consequences, and classification on the statement of cash flows. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of adopting ASU 2016-09 on its consolidated financial statements.

In May 2014, FASB issued *Revenue from Contracts with Customers, Topic 606 (Accounting Standards Update No. 2014-09 (ASU 2014-09))*, which provides a framework for the recognition of revenue, with the objective that recognized revenues properly reflect amounts an entity is entitled to receive in exchange for goods and services. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of adopting ASU 2014-09 on its consolidated financial statements.

There have been no other significant changes in recent accounting pronouncements during the six months ended June 30, 2016 as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

(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 has financed its operations to date principally through the sale of equity securities, debt financing and interest earned on investments. As of June 30, 2016, the Company had $11.5 million of cash and cash equivalents to fund its operations through 2016.

On November 4, 2015, the Company entered into a securities purchase agreement (the Purchase Agreement) with institutional investors to issue $25.0 million of senior amortizing convertible notes (the Notes) along with the accompanying warrants. $1.5 million of the Notes was funded at the first closing on November 9, 2015 (the First Closing). An additional $11.0 million of the Notes was funded at the second closing on January 11, 2016 (the Second Closing). Pursuant to two amendments to the Purchase Agreement entered into on May 2, 2016 (the First Amendment), and July 14, 2016 (the Second Amendment), $6.25 million was funded at the third closing on May 2, 2016 (The Third Closing) and the remaining amount, up to $6.25 million, will be funded at the fourth closing, which is scheduled to occur not later than December 1, 2016 (the Fourth Closing), subject to certain terms and conditions (see Note 6). Additionally, the Company has agreed that it will not, for a period of one year after the First Closing, issue any further securities, other than certain excluded securities.

The Company's operations include plans that consider the controlled commercial launch of vBloc Therapy, delivered via the Maestro Rechargeable System, which was approved by the FDA on January 14, 2015. The Company believes that it has the ability to manage the growth of its expenditures and operations depending on the amount of available cash flows. However, the Company will ultimately need to achieve sufficient revenues from product sales and/or obtain additional debt or equity financing to support its operations.

In May 2016, the Company received written notices from the Nasdaq Stock Market Nasdaq stating that the Company was not in compliance with the following two Nasdaq listing requirements: (1) the requirement that the Company have a minimum of $2.5 million stockholders' equity (the Stockholders' Equity Requirement) and (2) the $1.00 minimum bid price stock price requirement (the Minimum Bid Requirement).

On July 19, 2016, the Company received a letter from Nasdaq granting the Company an extension until November 14, 2016 to regain compliance with the Stockholders' Equity Requirement. The extension was granted based on the plan the Company submitted to Nasdaq to regain compliance with the Stockholders' Equity Requirement through a combination of note conversions and accelerated principal amortizations and infusions of equity capital prior to the deadline.

The Company has 180 calendar days from the May 9, 2016 notice date to regain compliance with the Minimum Bid Requirement. In the event the Company does not regain compliance with this requirement, Nasdaq will provide the Company with written notification that its securities are subject to delisting. At that time, the Company may appeal the delisting determination to a Nasdaq Hearings Panel.

Alternatively, if the Company fails to regain compliance with the Minimum Bid Requirement prior to the expiration of the 180 calendar day period, the Company may be granted an additional 180 calendar days to regain compliance with the Minimum Bid Requirement if it (i) meets the continued listing requirement for market value of publicly held shares and all of the other applicable requirements for initial listing on Nasdaq other than the Minimum Bid Requirement, and (ii) provides written notice of its intention to cure the deficiency during the second compliance period by effecting a reverse stock split, if necessary.

The Company is actively monitoring its performance with respect to the Stockholders' Equity Requirement and the Minimum Bid Requirement and will consider all available options to resolve each deficiency and regain compliance with the Nasdaq listing requirements.

(3) Short-term Investments and Fair Value Measurements

Fair value of financial assets and liabilities is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2—Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active or model-derived valuations for which all significant inputs are observable, either directly or indirectly.
- Level 3—Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The Company's assets that are measured at fair value on a recurring basis are classified within Level 1 or Level 2 of the fair value hierarchy. The Company does not hold any assets that are measured at fair value using Level 3 inputs. The types of instruments the Company invests in that are valued based on quoted market prices in active markets may include U.S. treasury securities and money market funds. Such instruments are classified by the company within Level 1 of the fair value hierarchy. U.S. treasuries are valued using unadjusted quoted prices for identical assets in active markets that the Company can access.

The types of instruments the Company invests in that are valued based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include the Company's U.S. agency securities, commercial paper, U.S. corporate bonds and municipal obligations. Such instruments are classified by the Company within Level 2 of the fair value hierarchy. The Company values these types of assets using consensus pricing or a weighted average price, which is based on multiple pricing sources received from a variety of industry standard data providers (e.g. Bloomberg), security master files from large financial institutions, and other third-party sources. The multiple prices obtained are then used as inputs into a distribution-curve-based algorithm to determine the daily market price.

The Company did not hold any short-term investments classified as available for sale or held to maturity as of June 30, 2016 and December 31, 2015.

The fair value of the Company's common stock warrant liability is calculated using a Black-Scholes valuation model and is classified as Level 2 in the fair value hierarchy. The common stock warrants issued July 8, 2015 had a fair value of $352,206 and $2,759,583 on June 30, 2016 and December 31, 2015, respectively. The common stock warrants issued November 9, 2015 had a fair value of $15,442 and $118,234 on June 30, 2016 and December 31, 2015, respectively. The common stock warrants issued January 11, 2016 had a fair value of $54,125 and $515,157 on June 30, 2016 and January 11, 2016, respectively. The common stock warrants issued May 2, 2016 had a fair value of $32,883 and $150,195 on June 30, 2016 and May 2, 2016, respectively. The fair value was calculated using the following assumptions:

	July 2015 Warrants		November 2015 Warrants	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
Risk-free interest rates	0.71%	1.31%	1.01%	1.76%
Expected life	30 months	36 months	52 months	58 months
Expected dividends	0%	0%	0%	0%
Expected volatility	93.04%	97.94%	94.99%	86.27%

	January 2016 Warrants		May 2016 Warrants	
	June 30, 2016	January 11, 2016	June 30, 2016	May 2, 2016
Risk-free interest rates	1.01%	1.58%	1.01%	1.32%
Expected life	54 months	60 months	58 months	60 months
Expected dividends	0%	0%	0%	0%
Expected volatility	93.53%	85.90%	92.31%	89.28%

The following table summarizes fair value measurements of the Notes and the common stock warrants issued in 2015 and during the six months ended June 30, 2016 by level at June 30, 2016:

	Level 1	Level 2	Level 3	Total
Senior amortizing convertible notes			$14,335,000	$14,335,000
Common stock warrants		$463,422		463,422
Total		$463,422	$14,335,000	$14,798,422

Through June 30, 2016, the Company had converted $3.2 million of the Notes' principal and interest into shares of common stock. For the three month and six month periods ended June 30, 2016, respectively, there were gains of $1.2 million and $709,000 recognized in the condensed consolidated statements of operations from changes in fair value of the Notes.

On June 30, 2016 and December 31, 2015, the fair value of the outstanding Notes from the First Closing was determined to be $942,000 and $1.3 million, respectively. On June 30, 2016 and January 11, 2016, the fair value of the outstanding Notes from the Second Closing was determined to be $7.9 million and $9.9 million, respectively. On June 30, 2016 and May 2, 2016, the fair value of the outstanding Notes from the Third Closing was determined to be $5.5 million and $6.0 million, respectively. The fair values were calculated using a Binomial Lattice model and the following assumptions:

	November 2015 Notes		January 2016 Notes	
	June 30, 2016	December 31, 2015	June 30, 2016	January 11, 2016
Risk-free interest rates	0.54%	1.11%	0.54%	1.01%
Expected life	1.36 years	1.86 years	1.36 years	1.83 years
Expected dividends	0%	0%	0%	0%
Expected volatility	68.0%	57.5%	68.0%	60.0%
Fair value per share of common stock	$ 0.29	$ 1.95	$ 0.29	$ 1.33

	May 2016 Notes	
	June 30, 2016	May 2, 2016
Risk-free interest rates	0.54%	0.69%
Expected life	1.36 years	1.52 years
Expected dividends	0%	0%
Expected volatility	68.0%	65.0%
Fair value per share of common stock	$ 0.29	$ 0.80

(4) Inventory

From the Company's inception, inventory related purchases had been used for research and development related activities and had accordingly been expensed as incurred. In December 2011, the Company began receiving ARTG listings for components of the Maestro Rechargeable System from the Australian Therapeutic Goods Administration, with the final components being listed on the ARTG in January 2012. As a result, the Company determined certain assets were recoverable as inventory beginning in December 2011. The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets. There was approximately $609,000 and $519,000 of long-term inventory, primarily consisting of raw materials, as of June 30, 2016 and December 31, 2015, respectively.

Current inventory consists of the following as of:

	June 30, 2016	December 31, 2015
Raw materials	$ 626,725	$ 576,898
Work-in-process	1,310,121	1,066,345
Finished goods	20,975	43,081
Inventory	$1,957,821	$1,686,324

(5) Commitments and Contingencies

Operating Lease

The Company rents its office, warehouse and laboratory facilities under an operating lease, which was originally set to expire on September 30, 2015. On August 25, 2015, the Company entered into an amendment extending the term of the operating lease for three years until September 30, 2018, with monthly base rent ranging from $18,925 to $20,345. Total rent expense recognized for each of the three month periods ended June 30, 2016 and 2015 was $58,905 and $67,718, and for each of the six month periods ended June 30, 2016 and 2015 was $117,810 and $135,436.. At June 30, 2016, future minimum payments under the lease are as follows:

Year ending December 31:	
Remaining six months in 2016	$117,810
2017	235,620
2018	176,715
	$530,145

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 litigation and is not aware of any pending or threatened litigation that could have a material adverse effect on the Company's business, operating results or financial condition.

Clinical Trials

The Company is evaluating the Maestro System in human clinical trials, including the EMPOWER trial and ReCharge trial. Both of these clinical trials require patients to be followed out to 60 months. The Company is required to pay for patient follow up visits only to the extent they occur. In the event a patient does not attend a follow up visit, the Company has no financial obligation. The Company is also required to pay for explants or revisions, including potential conversions of ReCharge control devices to active devices, should a patient request or be required to have one during the course of the clinical trials. The Company has no financial obligation unless an explant, revision or conversion is requested or required. Clinical trial costs are expensed as incurred.

(6) Senior Amortizing Convertible Notes

On November 4, 2015, the Company entered into the Purchase Agreement to issue and sell to four institutional investors 7% senior amortizing convertible notes due 2017 in three separate closings. The Notes are convertible into shares of the Company's common stock at a price equal to $4.35 per share with an aggregate principal amount of $25.0 million. Each Note was sold with a warrant to purchase a share of common stock (the Warrants) with an exercise price of $4.65 per share. The Company issued and sold Notes and Warrants for aggregate total proceeds of $12.5 million in two separate closings through March 31, 2016, and after entering into the First Amendment, which provided that the scheduled third closing would be split into two separate closings, issued and sold Notes and Warrants for aggregate total proceeds of $6.25 million in the Third Closing. The Company will issue and sell Notes and Warrants for aggregate total proceeds of up to $6.25 million in the Fourth Closing, which pursuant to the Second Amendment, is scheduled to occur no later than December 1, 2016. The Second Amendment provides that the Company may reduce the conversion price of the Notes from time to time in order to incentivize the holders of the Notes to convert their Notes into shares of the Company's common stock. In addition, at the Fourth Closing, the holders of the Notes will be obligated to purchase at least 50% of the aggregate principal of the Notes they convert, either on a voluntary or installment conversion basis, on and after July 1, 2016, up to an aggregate principal amount of $6.25 million, although no holder will be obligated to purchase more Notes than originally scheduled in the First Amendment. Between July 1, 2016 and August 11, 2016, $2.6 million of aggregate principal amount of Notes were converted by holders of the Notes into approximately 14.1 million shares of the Company's common stock.

Description of the Notes

The Notes are payable in monthly installments, accrue interest at a rate of 7.0% per annum from the date of issuance and will mature 24 months after the First Closing, unless converted or redeemed earlier. The Notes may be repaid, at the Company's election, in either cash or shares of the Company's common stock at a discount to the then-current market price. The Notes are also convertible from time to time, at the election of the holders, into shares of the Company's common stock at an initial conversion price of $4.35 per share. The conversion price was adjusted to $1.09 per share on January 29, 2016, the 16th trading day following the Reverse Stock Split, per the terms of the Notes.

The holder of each Note has the right to convert any portion of such Note unless the holder, together with its affiliates, beneficially owns in excess of 4.99% of the number of shares of the Company's common stock outstanding immediately after giving effect to the conversion, as such percentage ownership is determined in accordance with the terms of the Notes. However, any holder may increase or decrease such percentage to any other percentage, but in no event above 9.99%, provided that any increase of such percentage will not be effective until 61 days after providing notice to the Company.

The Company has determined that the conversion feature in the Notes requires bifurcation and liability classification and measurement, at fair value, and requires evaluation at each reporting period. Under Accounting Standards Codification (ASC) 825,

Financial Instruments, the FASB provides an alternative to bifurcation and companies may instead elect fair value measurement for the entire instrument, including the debt and conversion feature. The Company has elected the fair value alternative in order to simplify its accounting and reporting of the Notes upon issuance. The fair value of the Warrants is recorded as a discount to the Notes and amortized to interest expense following the effective interest rate method over the term of the Notes.

The First Closing occurred on November 9, 2015. At the First Closing, the Company issued and sold Notes with an aggregate principal amount of $1.5 million, along with Warrants exercisable for 117,520 shares.

The Second Closing occurred on January 11, 2016 after the Company received approval of the offering by the Company's stockholders and the satisfaction of certain customary closing conditions. At the Second Closing, the Company issued and sold Notes with an aggregate principal amount of $11.0 million, along with Warrants exercisable for 861,842 shares. The fair value of the Warrants issued on January 11, 2016 was determined to be $515,000 using a Black-Scholes valuation model and the following assumptions: (1) dividend yield of 0%; (2) expected volatility of 85.90%; (3) weighted average risk –free interest rate of 1.58%; and (4) expected life of 5.0 years.

The Third Closing occurred on May 2, 2016 after the Company entered into the First Amendment and satisfied certain closing conditions. At the Third Closing, the Company issued and sold Notes with an aggregate principal amount of $6.25 million, along with Warrants exercisable for 489,684 shares.

At the Fourth Closing, the Company will issue and sell Notes with an aggregate principal amount of up to $6.25 million, along with Warrants exercisable for 489,682 shares.

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the First Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at December 31, 2015	$ 65,217	$ 23,651	$ 88,868	56,967
Holder conversions during the quarter ended December 31, 2015	18,261	2,375	20,636	13,228
Balance, December 31, 2015	83,478	26,026	109,504	70,195
Installment amount at February 29, 2016	65,217	23,681	88,898	91,953
Installment amount at March 31,2016	65,217	14,827	80,044	88,960
Holder conversions during the quarter ended March 31, 2016	104,784	12,762	117,546	106,684
Balance, March 31, 2016	$318,696	$ 77,296	$395,992	357,792
Installment amount at April 30, 2016	65,217	13,853	79,070	101,764
Installment amount at May 31, 2016	65,217	13,082	78,299	148,467
Installment amount at June 30, 2016	54,217	11,275	65,492	251,320
Holder conversions during the quarter ended June 30, 2016	1,627	174	1,801	2,000
Balance, June 30, 2016	$504,974	$115,680	$620,654	861,343

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the Second Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at March 2, 2016	$ 404,762	$149,300	$ 554,062	*
Holder conversions during the quarter ended March 31, 2016	987,000	124,050	1,111,050	1,048,167
Balance, March 31, 2016	1,391,762	273,350	1,665,112	1,048,167

	Principal	Interest	Total	Common Shares
Installment amount at April 29, 2016	404,762	149,497	554,259	713,334
Installment amount at May 31, 2016	291,428	86,518	377,946	716,625
Installment amount at June 30, 2016	404,762	82,913	487,675	1,598,908
Holder conversions during the quarter ended June 30, 2016	25,373	2,995	28,368	29,000
Balance, June 30, 2016	$2,518,087	$595,273	$3,113,360	$4,106,034

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the Third Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at June 30, 2016	$212,158	$90,659	$302,817	$1,162,000
Balance, June 30, 2016	$212,158	$90,659	$302,817	$1,162,000

* Cash payments

Description of the Warrants

Each Warrant is exercisable immediately and for a period of 60 months from the date of the issuance of the Warrant. Upon the completion of the Fourth Closing, the Warrants will entitle the holders of the Warrants to purchase, in aggregate, 1,958,728 shares of the Company's common stock, subject to certain adjustments. The Warrants were initially exercisable at an exercise price equal to $4.65, subject to adjustment on the eighteen month anniversary of issuance, and certain other adjustments. The exercise price and number of shares of common stock issuable on the exercise of the Warrants is subject to adjustment upon the issuance of any shares of common stock or securities convertible into shares of common stock below the then-existing exercise price, with certain exceptions, and in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. The holder of each Warrant does not have the right to exercise any portion of such Warrant if the holder, together with its affiliates, beneficially owns in excess of 4.99% of the number of shares of the Company's common stock outstanding immediately after giving effect to the exercise, as such percentage ownership is determined in accordance with the terms of the Warrants. However, any holder may increase or decrease such percentage to any other percentage, but in no event above 9.99%, provided that any increase of such percentage will not be effective until 61 days after providing notice to the Company.

The exercise price of the Warrants issued November 9, 2015 was reduced to $1.09 per share on January 29, 2016, the 16th trading day following the Reverse Stock Split, per the terms of the Warrants. The exercise price of the Warrants issued January 11, 2016 and May 2, 2016 remains $4.65 per share per the terms of the Warrants. All of the Warrants issued with the Notes remain subject to adjustment on the eighteen month anniversary of issuance.

(7) Stock-based Compensation

The fair value method of accounting for share-based payments is applied to all share-based payment awards issued to employees and where appropriate, nonemployees, unless another source of literature applies. When determining the measurement date of a nonemployee's share-based payment award, the Company measures the stock options at fair value and remeasures such stock options to the current fair value until the performance date has been reached.

Based on the application of these standards, stock-based compensation expense for stock-based awards under the Company's Amended and Restated 2003 Stock Incentive Plan (the Plan) and inducement grants for the three and six months ended June 30, 2016 and 2015 was allocated to operating expenses and employees and nonemployees as follows:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Selling, general and administrative	$581,857	$1,205,445	$1,421,634	$2,241,891
Research and development	172,267	343,264	424,978	678,894
Total	$754,124	$1,548,709	$1,846,612	$2,920,785

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Employees	$752,996	$1,552,108	$1,843,188	$2,940,032
Nonemployees	$ 1,128	(3,399)	3,424	(19,247)
Total	$754,124	$1,548,709	$1,846,612	$2,920,785

On June 27, 2016 the Company completed an option exchange offer to its employees whereby certain outstanding options to purchase shares of the Company's common stock were tendered by employees in exchange for new options with the exercise price to be set at the then current market price of the Company's common stock. Options to purchase 449,706 shares of the Company's common stock, which included all the options eligible for exchange, were tendered by employees and cancelled by the Company. On the same date, options to purchase 75,819 shares of the Company's common stock were issued with an exercise price of $0.3325 per share, which was the Company's closing stock price on June 27, 2016. Because the fair value of the tendered options immediately before the exchange approximated the fair value of the new options granted, no additional compensation expense was recognized.

As of June 30, 2016 there was approximately $1.8 million of total unrecognized compensation costs, net of estimated forfeitures, related to employee unvested stock option awards, which are expected to be recognized over a weighted-average period of 3.26 years.

The estimated grant-date fair values of the stock options were calculated using the Black-Scholes valuation model, based on the following assumptions for the three and six months ended June 30, 2016 and 2015:

	Employees Three months ended June 30,		Employees Six months ended June 30,	
	2016	2015	2016	2015
Risk-free interest rates	0.87%-1.34%	1.49%-1.75%	0.87%-1.64%	1.49%-1.80%
Expected life	4.00-6.00 years	5.50-6.25 years	4.00-6.25 years	5.50-6.25 years
Expected dividends	0%	0%	0%	0%
Expected volatility	92.38%-96.10%	83.36%-108.23%	88.43%-96.10%	83.36%-111.77%

	Nonemployees Three months ended June 30,		Nonemployees Six months ended June 30,	
	2016	2015	2016	2015
Risk-free interest rates	0.89%	0.02%-2.10%	0.89%-1.11%	0.02%-2.10%
Expected life	4.14 years	0.08-8.26 years	4.14-4.39 years	0.08-8.51 years
Expected dividends	0%	0%	0%	0%
Expected volatility	96.33%	22.42%-132.01%	92.41%-96.33%	22.42%-132.01%

Option activity under the Plan for the six months ended June 30, 2016 was as follows:

		Outstanding Options	
	Shares Available For Grant	Number of Shares	Weighted-Average Exercise Price
Balance, December 31, 2015	296,579	1,018,752	$ 32.83
Shares reserved	—	—	—
Options granted	(150,485)	150,485	0.65
Options exercised	—	—	—
Options cancelled	504,995	(504,995)	29.37
Balance, June 30, 2016	651,089	664,242	**28.17**

In addition to the stock options granted pursuant to the Plan, the Company has also granted inducement stock options in connection with the appointments of (i) Dan Gladney to the position of President and Chief Executive Officer on October 28, 2015, (ii) Nick Ansari to the position of Senior Vice President (SVP) of Sales on January 6, 2016, (iii) Peter DeLange to the position of SVP of Operations and Business Development on January 18, 2016 and (iv) Paul Hickey to the position of SVP of Marketing and Reimbursement on January 18, 2016. Mr. Gladney was granted an option to purchase 516,666 shares of the Company's common stock as an inducement grant, with an exercise price of $3.75 per share, the closing price of the Company's common stock on October 28, 2015. Mr. Delange was granted an option to purchase 166,667 shares of the Company's common stock as an inducement grant, with an exercise price of $1.38 per share, the closing price of the Company's common stock on January 18, 2016. Mr. Ansari was granted an option to purchase 106,667 shares of the Company's common stock as an inducement grant, with an exercise price of $1.31 per share, the closing price of the Company's common stock on January 19, 2016. Mr. Hickey was granted an option to purchase 106,667 shares of the Company's common stock as an inducement grant, with an exercise price of $1.32 per share, the closing price of the Company's common stock on January 22, 2016. Each of the inducement grants will vest as follows: 25% of the shares will vest as of one year from the date of the officer's employment agreement, and the remaining 75% of the shares will then vest in equal 2.0833% installments each month thereafter for 36 months. The inducement options were not eligible for the option exchange program.

(8) Stock Sales

Sales Agreement—July 2015

On July 8, 2015, the Company closed a public offering, where it sold 2,133,333 units at an aggregate price of $7.50 per unit, for gross proceeds of $16.0 million before deducting estimated offering expenses of approximately $1.4 million, of which $532,000 was assigned to the warrants issued with each unit sold and was recognized immediately as interest expense in the condensed consolidated statements of operations as the warrants are exercisable upon issuance. Each unit consisted of: (A)(i) one share of common stock or (ii) one pre-funded Series C warrant to purchase one share of common stock at an exercise price equal to $7.50 per share (Series C Warrant); and (B) one Series A warrant to purchase one share of common stock at an exercise price initially equal to $9.00 per share (Series A Warrant). Each purchaser of a unit could elect to receive a Series C Warrant in lieu of a share of common stock. No Series C Warrants were issued.

The Series A Warrants are exercisable for a period of 42 months from the closing date of the public offering. The exercise price and number of shares of common stock issuable on the exercise of the Series A Warrants are subject to adjustment upon the issuance

of any shares of common stock or securities convertible into shares of common stock below the then-existing exercise price, with certain exceptions, and in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. The holder of the Series A Warrant does not have the right to exercise any portion of the Series A Warrant if the holder, together with its affiliates, would, subject to certain limited exceptions, beneficially own in excess of 9.99% of the Company's common stock outstanding immediately after the exercise or 4.99% as may be elected by the purchaser.

The exercise price of the Series A Warrants issued July 8, 2015 was reduced to $2.40 per share on November 9, 2015 as a result of the issuance of the Notes and was further reduced to $1.50 per share on December 31, 2015, $0.97 per share on January 29, 2016, and $0.88 on March 30, 2016, $0.26 on June 30, 2016, and $0.19 on August 1, 2016 after installment payments on the Notes were made.

Sales Agreement—June 2014

On June 13, 2014, the Company entered into a sales agreement with Cowen and Company, LLC (Cowen) to sell shares of the Company's common stock having aggregate gross sales proceeds of up to $25.0 million, from time to time, through an "at-the-market" equity offering program under which Cowen will act as the Company's sales agent (the Cowen ATM). The Company will determine, at its sole discretion, the timing and number of shares to be sold under the Cowen ATM. The Company will pay Cowen a commission for its services in acting as agent in the sale of common stock equal to 3.0% of the gross sales price per share of all shares sold through it as agent under the sales agreement. As of June 30, 2016, the Company had sold 367,903 shares under the Cowen ATM at a weighted-average selling price of $20.60 per share for gross proceeds of $7.6 million before deducting offering expenses. There have been no shares sold under the Cowen ATM subsequent to June 30, 2016 through August 11, 2016. The Company is restricted from issuing shares under the Cowen ATM until November 9, 2016 per the terms of the Purchase Agreement (see Notes 2 and 7).

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 Part I, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2015. 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 a medical device company with approvals to commercially launch our product, the Maestro Rechargeable System, in the United States, Australia, the European Economic Area and other countries that recognize the European CE Mark. We are focused on the design and development of devices that use neuroblocking technology to treat obesity, metabolic diseases and other gastrointestinal disorders. Our proprietary neuroblocking technology, which we refer to as vBloc Therapy, is designed to intermittently block the vagus nerve using high frequency, low energy, electrical impulses. We have a limited operating history and only recently received U.S. Food and Drug Administration (FDA) approval to sell our product in the United States. In addition, we have regulatory approval to sell our product in Australia, the European Economic Area and other countries that recognize the European CE Mark and do not have any other source of revenue. We were incorporated in Minnesota on December 19, 2002 and later reincorporated in Delaware on July 22, 2004. We have devoted substantially all of our resources to the development and commercialization of the Maestro Rechargeable System.

The Maestro Rechargeable System, our initial product, uses vBloc Therapy to limit the expansion of the stomach, help control hunger sensations between meals, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. We believe the Maestro Rechargeable System offers obese patients a minimally-invasive treatment that can result in significant, durable and sustained weight loss. We believe that our Maestro Rechargeable System allows bariatric surgeons to offer a new option to obese patients who are concerned about the risks and complications associated with currently available anatomy-altering, restrictive or malabsorptive surgical procedures.

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the Maestro Rechargeable System, for the treatment of adult patients with obesity who have a Body Mass Index (BMI) of at least 40 to 45 kg/m2, or a BMI of at least 35 to 39.9 kg/m2 with a related health condition such as high blood pressure or high cholesterol levels, and who have tried to lose weight in a supervised weight management program and failed within the past five years. We have begun a controlled commercial launch at select centers in the United States and had our first commercial sales in 2015. During 2015, we began a controlled expansion of our commercial operations and started the process of building a sales force. In January 2016, we hired three new executives to oversee this expansion. The direct sales force is supported by field technical managers who provide training, technical and other support services to our customers. Throughout 2015, our sales force called directly on key opinion leaders and bariatric surgeons at commercially-driven centers that met our certification criteria, which led to the training and certification of over 50 centers and 75 surgeons in implanting and administering vBloc Therapy. We have continued these efforts in the first six months of 2016 and plan to build on these efforts during the remainder of 2016 through geography and self-pay patient focused direct-to-patient marketing, key opinion leader and center specific partnering, and a multi-faceted reimbursement strategy. To date, we have relied on, and anticipate that we will continue to rely on, third-party manufacturers and suppliers for the production of the Maestro Rechargeable System.

Data from our ReCharge trial was used to support the premarket approval (PMA) application for the Maestro Rechargeable System, submitted to the FDA in June 2013. The ReCharge trial is a randomized, double-blind, sham-controlled, multicenter pivotal clinical trial testing the effectiveness and safety of vBloc Therapy utilizing our Maestro Rechargeable System. All patients in the trial received an implanted device and were randomized in a 2:1 allocation to treatment or sham control groups. The sham control group received a non-functional device during the trial period. All patients were expected to participate in a standard weight management counseling program. The primary endpoints of efficacy and safety were evaluated at 12 months. As announced, the ReCharge trial met its primary safety endpoint with a 3.7% serious adverse event rate. The safety profile at 12 months was further supported by positive cardiovascular signals including a 5.5 mmHg drop in systolic blood pressure, a 2.8 mmHg drop in diastolic blood pressure and a 3.6 bpm drop in average heart rate.

Although the trial did not meet its predefined co-primary efficacy endpoints, it did demonstrate in the intent to treat (ITT) population (n=239) a clinically meaningful and statistically significant excess weight loss (EWL) of 24.4% (approximately 10% total body weight loss (TBL)) for vBloc Therapy-treated patients, with 52.5% of patients achieving at least 20% EWL. In the per protocol population, the trial demonstrated an EWL of 26.3% for vBloc Therapy-treated patients, with 56.8% of patients achieving at least 20% EWL.

In the ReCharge trial, two-thirds of vBloc Therapy-treated patients achieved at least 5% TBL at 12 months. According to the Centers for Disease Control and Prevention (CDC), 5% TBL can have significant health benefits on obesity related risk factors, or comorbidities, including reduction in blood pressure, improvements in Type 2 diabetes and reductions in triglycerides and cholesterol. Further analysis of our data at 12 months showed a meaningful impact on these comorbidities as noted in the below table showing the improvements seen at 10% TBL, the average weight loss in vBloc Therapy-treated patients.

Risk Factor	10% TBL
Systolic BP (mmHg)	-9
Diastolic BP (mmHg)	-6
Heart Rate (bpm)	-6
Total Cholesterol (mg/dL)	-15
LDL (mg/dL)	-9
Triglycerides (mg/dL)	-41
HDL (mg/dL)	3
Waist Circumference (inches)	-7
HbA1c (%)	-0.5

We subsequently announced that vBloc Therapy-treated patients were maintaining their weight loss at 18 months and 24 months with an EWL of 23.5% and 21.1%, respectively. The trial's positive safety profile also continued throughout this reported time period.

We obtained European CE Mark approval for our Maestro Rechargeable System in 2011 for the treatment of obesity. The CE Mark approval for our Maestro Rechargeable System was expanded in 2014 to also include use for the management of Type 2 diabetes in obese patients. In January 2012, the final Maestro Rechargeable System components were listed on the Australian Register of Therapeutic Goods (ARTG) by the Therapeutic Goods Administration (TGA). The costs and resources required to successfully commercialize the Maestro Rechargeable System internationally are currently beyond our capability. Accordingly, we intend to devote our near-term efforts toward mounting a successful system launch in the United States. We intend to explore select international markets to commercialize the Maestro Rechargeable System as our resources permit, using direct, dealer and distributor sales models as the targeted market best dictates.

To date, we have not observed any mortality related to our device or any unanticipated adverse device effects in our human clinical trials. We have also not observed any long-term problematic clinical side effects in any patients. In addition, data from our VBLOC-DM2 ENABLE trial outside the United States demonstrate that vBloc Therapy may hold promise in improving obesity-related comorbidities such as diabetes and hypertension. We are conducting, or plan to conduct, further studies in each of these comorbidities to assess vBloc Therapy's potential in addressing multiple indications.

We recently commenced commercial operations in the United States, deriving revenues from our primary business activity in 2015. We expect to incur significant sales and marketing expenses prior to recording sufficient revenue to offset these expenses. We expect our selling, general and administrative expenses to increase as we continue to add the infrastructure necessary to support our initial commercial sales, operate as a public company and develop our intellectual property portfolio. For these reasons, we expect to continue to incur operating losses for the next several years. We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments.

Our board of directors and stockholders approved a 1-for-15 reverse split of the Company's outstanding common stock that became effective after trading on January 6, 2016 (the Reverse Stock Split). The Reverse Stock Split did not change the par value of our stock or the number of preferred shares authorized by our Fifth Amended and Restated Certificate of Incorporation. An amendment to the Certificate of Incorporation was also approved in connection with the Reverse Stock Split to increase the number of shares of our common stock authorized for issuance to 150 million shares, effective immediately after the Reverse Stock Split on January 6, 2016. All share and per share amounts have been retroactively adjusted to reflect the Reverse Stock Split for all periods presented.

Financial Overview

Revenue

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the Maestro Rechargeable System, and have begun a controlled commercial launch at select centers in the United States. In 2015 we trained and certified over 50 centers and 75 surgeons in implanting and administering vBloc Therapy. We had our first commercial sales within the United States in 2015 and for the year ended December 31, 2015 we recognized $292,000 in revenue. We have not generated revenue from commercial sales outside of the United States since 2012.

Any revenue from initial sales of a new product in the United States or internationally is difficult to predict and in any event will only modestly reduce our continued losses resulting from our research and development and other activities.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses consist primarily of compensation for executive, finance, market development and administrative personnel, including stock-based compensation. Other significant expenses include professional services and consulting fees, costs associated with attending medical conferences, other professional fees for legal services, including legal services associated with our efforts to obtain and maintain broad protection for the intellectual property related to our products, and accounting services, cash management fees and travel expenses.

Research and Development Expenses

Our research and development expenses primarily consist of engineering, product development, quality assurance and clinical and regulatory expenses, incurred in the development of our Maestro Rechargeable System. Research and development expenses also include employee compensation, including stock-based compensation, consulting services, outside services, materials, clinical trial expenses, including supplies, devices, explants and revisions, depreciation and travel. We expense research and development costs as they are incurred.

Results of Operations

Comparison of the Three Months Ended June 30, 2016 and 2015

Sales. Sales were $276,000 for the three months ended June 30, 2016, compared to $79,000 sales for the three months ended June 30, 2015. The increase of $197,000 is the result of receiving FDA approval on January 14, 2015 and commencing a controlled commercial launch of the Maestro Rechargeable System at select centers in the United States which resulted in sales of 23 units during the second quarter of 2016 versus six units during the second quarter of 2015.

Cost of Goods Sold. Cost of goods sold were $155,000 for the three months ended June 30, 2016, compared to $31,000 cost of goods sold for the three months ended June 30, 2015. The expense increase was driven primarily by the 283% increase in unit sales over the prior year period. The Company’s gross margin percentage declined to 43.8% for the three months ended June 30, 2016 from 61.1% due primarily to a reduction in average sales price and, to a lesser degree, by an increase in overhead costs applied to inventory.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $5.6 million for the three months ended June 30, 2016, compared to $4.9 million for the three months ended June 30, 2015. The increase of $0.7 million, or 13.2%, was primarily due to increases of $830,000 in professional services partially offset by declines in payroll-related expenses of $272,000. The increase in professional services expenses are the result of increasing commercialization efforts after receiving FDA approval on January 14, 2015 and beginning a controlled commercial launch at select centers in the United States.

Research and Development Expenses. Research and development expenses declined to $1.2 million for the three months ended June 30, 2016 from $2.5 million for the three months ended June 30, 2015. The decrease of $1.3 million, or 51.3%, was primarily due to decreases of $272,000, $228,000, and $362,000 in payroll-related expenses, professional services expenses and supplies expenses, respectively. The decreases are the result of a shift away from a research and development focus towards commercialization following FDA approval on January 14, 2015.

Interest Expense. Interest expense was $853,000 for the three months ended June 30, 2016, compared to $60,000 for the three months ended June 30, 2015. The increase of $793,000 was driven by interest costs from the three closings of the senior amortizing convertible notes (the Notes), that occurred on November 9, 2015, January 11, 2016 and May 2, 2016, as well as approximately $277,000 in debt issuance costs expensed as interest during the second quarter of 2016.

Change in Value of Convertible Notes Payable. The value of the Notes payable declined $1.2 million during the three months ended June 30, 2016. There were no Notes outstanding for the three months ended June 30 2016 as the notes were issued November 9, 2015, January 11, 2016 and May 2, 2016. The Notes contain a conversion feature and the decline in the Company's common stock price from $0.97 to $0.20 on June 30, 2016 was the primary driver of the reduction in the fair value of the Notes. The fair market value was calculated using a Binomial Lattice model.

Change in Value of Warrant Liability. The value of the common stock warrant liability decreased $1.3 million for the three months ended June 30, 2016. There were no warrants outstanding that were required to be measured at fair value for the six months ended June 30, 2015. Common stock warrant liabilities were recorded on July 8, 2015, November 9, 2015, January 11, 2016 and May 2, 2016, as the common stock warrants issued with the July 8, 2015 public offering and with the Notes provide for certain anti-dilution protections in the event shares of common stock or securities convertible into shares of common stock are issued below the then-existing exercise price. The fair market value was calculated using the Black-Scholes valuation model, which resulted in $846,000, $60,000, $285,000 and $117,000 decreases for the three months ended June 30, 2016 for the common stock warrants issued with the July 8, 2015 public offering, November 9, 2015 Notes, the January 11, 2016 Notes and the May 2, 2016 Notes, respectively, as our stock price decreased from $0.97 on March 31, 2016 and $0.75 on May 2, 2016 to $0.20 on June 30, 2016.

Comparison of the Six Months Ended June 30, 2016 and 2015

Sales. Sales were $348,000 for the six months ended June 30, 2016, compared to $79,000 sales for the six months ended June 30, 2015. The increase of $269,000 is the result of receiving FDA approval on January 14, 2015 and commencing a controlled commercial launch of the Maestro Rechargeable System at select centers in the United States which resulted in sales of 29 units during the six months ended June 30, 2016 versus six units during the comparable period from 2015.

Cost of Goods Sold. Cost of goods sold were $195,000 for the six months ended June 30, 2016, compared to $31,000 for the six months ended June 30, 2015. The expense increase was driven primarily by the 480% increase in unit sales over the prior year period. The Company's gross margin percentage declined to 43.8% for the six months ended June 30, 2016 from 61.1% due primarily to a reduction in average sales price and, to a lesser degree, by an increase in overhead costs applied to inventory.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $11.7 million for the six months ended June 30, 2016, compared to $9.7 million for the six months ended June 30, 2015. The increase of $2.1 million, or 21.3%, was primarily due to a $2.0 million increase in professional services expenses The increase in professional services are the result of increasing commercialization efforts after receiving FDA approval on January 14, 2015 and beginning a controlled commercial launch at select centers in the United States.

Research and Development Expenses. Research and development expenses were $2.6 million for the six months ended June 30, 2016, compared to $4.7 million for the six months ended June 30, 2015. The decrease of $2.1 million or 44.0%, was primarily due to decreases of $947,000. $502,000 and $426,000 in payroll-related expenses, professional services expenses and supply expenses, respectively. The decreases are the result of a shift away from a research and development focus towards commercialization following FDA approval on January 14, 2015.

Interest Expense. Interest expense was $2.0 million for the six months ended June 30, 2016, compared to $275,000 for the six months ended June 30, 2015. The increase of $1.7 million is primarily due to the interest expense recognized during the period for the three closings of the Notes that occurred on November 9, 2015, January 11, 2016 and May 2, 2016. Additionally, approximately $960,000 of debt issuance costs were recognized in the first two quarters of 2016 as interest expense as we elected the fair value alternative for the Notes. Interest expense recognized for the six months ended June 30, 2015 included a $187,000 success fee paid to Silicon Valley Bank required by the Loan and Security Agreement as a result of achieving FDA approval on January 14, 2015.

Change in Value of Convertible Notes Payable. The value of the Notes payable declined $709,000 million during the six months ended June 30, 2016. There were no Notes outstanding for the six months ended June 30, 2016 as the Notes were issued November 9, 2015, January 11, 2016 and May 2, 2016. The Notes contain a conversion feature and the decline in the Company's common stock price from $1.95 at December 31, 2015, $1.33 on January 11, 2016 and $0.75 at May 20, 2016 to $0.20 on June 30, 2016 was the primary driver of the reduction in the fair value of the Notes. The fair market value was calculated using a Binomial Lattice model.

Change in Value of Warrant Liability. The value of the common stock warrant liability decreased $3.1 million for the six months ended June 30, 2016, primarily due to the decrease in the market value of the Company's common stock compared with the exercise price of warrants. There were no warrants outstanding that were required to be measured at fair value for the six months ended June 30, 2015. Common stock warrant liabilities were recorded on July 8, 2015, November 9, 2015 and January 11, 2016 as the common stock warrants issued with the July 8, 2015 public offering and with the Notes provide for certain anti-dilution protections in the event shares of common stock or securities convertible into shares of common stock are issued below the then-existing exercise price. The fair market value was calculated using the Black-Scholes valuation model, which resulted in $2.4 million, $103,000,

$461,000 and $117,000 decreases for the six months ended June 30, 2016 for the common stock warrants issued with the July 8, 2015 public offering, November 9, 2015 Notes, the January 11, 2016 Notes and the May 2, 2016 Notes, respectively, as our stock price decreased from $1.95 on December 31, 2015 and $1.33 on January 11, 2016 and $0.75 on May 2, 2016 to $0.20 on June 30, 2016.

Liquidity and Capital Resources

As of June 30, 2016, we had $11.5 million in cash and cash equivalents. Of this amount $2.8 million was invested in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Company or other government agency. These money market funds seek to preserve the value of the investment at $1.00 per share; however, it is possible to lose money investing in these funds. Cash in excess of immediate requirements is invested in accordance with our investment policy, primarily with a view to liquidity and capital preservation. At times, such deposits may be in excess of insured limits. We have not experienced any losses on our deposits of cash and cash equivalents.

We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments. As of June 30, 2016, we had $11.5 million of cash and cash equivalents to fund our anticipated operations through 2016. On November 4, 2015, we entered into a securities purchase agreement (the Purchase Agreement) with institutional investors to issue $25.0 million of Notes along with the accompanying warrants. $1.5 million of the Notes was funded at the initial closing on November 9, 2015 (the First Closing). An additional $11.0 million of the Notes were funded at the second closing on January 11, 2016 (the Second Closing). Pursuant to an amendment to the Purchase Agreement (the First Amendment) entered into on May 2, 2016, the remaining $12.5 million would be funded at two separate closings, with $6.25 million of the Notes funded on May 2, 2016 and the remaining amount, up to $6.25 million, scheduled to be funded no later than December 1, 2016. Additionally, we have agreed that we will not, for a period of one year after the First Closing, issue any further securities, other than certain excluded securities. Our anticipated operations include plans that consider the controlled commercial launch of vBloc Therapy, delivered via the Maestro Rechargeable System, which was approved by the FDA on January 14, 2015. We believe that we have the flexibility to manage the growth of our expenditures and operations. In order to accelerate the execution of our business plans we may need to raise additional funds.

Nasdaq Listing Notices

In May 2016, the Company received written notices from the Nasdaq Stock Market Nasdaq stating that the Company was not in compliance with the following two Nasdaq listing requirements: (i) the requirement that the Company have a minimum of $2.5 million stockholders' equity (the Stockholders' Equity Requirement) and (ii) the $1.00 minimum bid price stock price requirement (the Minimum Bid Requirement).

On July 19, 2016, the Company received a letter from Nasdaq granting the Company an extension until November 14, 2016 to regain compliance with the Stockholders' Equity Requirement. The extension was granted based on the plan the Company submitted to Nasdaq to regain compliance with the Stockholders' Equity Requirement through a combination of note conversions and accelerated principal amortizations and infusions of equity capital prior to the deadline.

The Company has 180 calendar days from the May 9, 2016 notice date to regain compliance with the Minimum Bid Requirement. In the event the Company does not regain compliance with this requirement, Nasdaq will provide the Company with written notification that its securities are subject to delisting. At that time, the Company may appeal the delisting determination to a Hearings Panel.

Alternatively, if the Company fails to regain compliance with the Minimum Bid Requirement prior to the expiration of the 180 calendar day period, the Company may be granted an additional 180 calendar days to regain compliance with the Minimum Bid Requirement if it (i) meets the continued listing requirement for market value of publicly held shares and all of the other applicable requirements for initial listing on Nasdaq other than the minimum bid price, and (ii) provides written notice of its intention to cure the deficiency during the second compliance period by effecting a reverse stock split, if necessary.

The Company intends to actively monitor its performance with respect to the Stockholders' Equity Requirement and the Minimum Bid Requirement and will consider all available options to resolve each deficiency and regain compliance with the Nasdaq listing requirements

Sales Agreement—June 2014

On June 13, 2014, we entered into a sales agreement with Cowen and Company, LLC (Cowen) to sell shares of our common stock having aggregate gross sales proceeds of up to $25.0 million, from time to time, through an "at-the-market" equity offering program under which Cowen will act as our sales agent (the Cowen ATM). We will determine, at our sole discretion, the timing and

number of shares to be sold under the Cowen ATM. We will pay Cowen a commission for its services in acting as agent in the sale of common stock equal to 3.0% of the gross sales price per share of all shares sold through it as agent under the sales agreement. As of June 30, 2016, we have sold 367,903 shares under the Cowen ATM at a weighted-average selling price of $20.60 per share for gross proceeds of $7.6 million before deducting offering expenses. There have been no shares sold under the Cowen ATM subsequent to June 30, 2016 through August 11, 2016. We are restricted from issuing shares under the Cowen ATM until November 9, 2016 per the terms of the Notes (further described below).

Sales Agreement—July 2015

On July 8, 2015, we closed a public offering where we sold 2,133,333 units at an aggregate price of $7.50 per unit, for gross proceeds of $16.0 million, before deducting estimated offering expenses of approximately $1.4 million, of which $532,000 was assigned to the warrants. Each unit consisted of: (A)(i) one share of common stock or (ii) one pre-funded Series C warrant to purchase one share of common stock at an exercise price equal to $7.50 per share (Series C Warrant); and (B) one Series A warrant to purchase one share of common stock at an exercise price equal initially to $9.00 per share (Series A Warrant). Each purchaser of a unit could elect to receive a Series C Warrant in lieu of a share of common stock. No Series C Warrants were issued.

The Series A Warrants are exercisable for a period of 42 months from the closing date of the public offering. The exercise price and number of shares of common stock issuable on the exercise of the Series A Warrants are subject to adjustment upon the issuance of any shares of common stock or securities convertible into shares of common stock below the then-existing exercise price, with certain exceptions, and in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. The holder of the Series A Warrant does not have the right to exercise any portion of the Series A Warrant if the holder, together with its affiliates, would, subject to certain limited exceptions, beneficially own in excess of 9.99% of our common stock outstanding immediately after the exercise or 4.99% as may be elected by the purchaser.

The exercise price of the Series A Warrants issued July 8, 2015 was reduced to $2.40 per share on November 9, 2015 as a result of the issuance of the Notes and was further reduced to $1.50 per share on December 31, 2015, $0.97 per share on January 29, 2016, $0.26 on June 30, 2016, and $0.20 on August 1, 2016 after installment payments on the Notes were made.

Senior Amortizing Convertible Notes

On November 4, 2015, we entered into the Purchase Agreement to issue and sell to four institutional investors 7% senior amortizing convertible notes due 2017 in three separate closings. The Notes are convertible into shares of our common stock at a price equal to $4.35 per share with an aggregate principal amount of $25.0 million. Each Note was sold with a warrant to purchase a share of common stock (the Warrants) with an exercise price of $4.65 per share. We issued and sold Notes and Warrants for aggregate total proceeds of $12.5 million in two separate closings through March 31, 2016, and after entering into the First Amendment, which provided that the scheduled third closing would be split into two separate closings, issued and sold Notes and Warrants for aggregate total proceeds of $6.25 million in the third closing, which occurred on May 2, 2016 (the Third Closing). We will issue and sell Notes and Warrants for aggregate total proceeds of up to $6.25 million in the fourth and final closing (the Fourth Closing). Additionally, the Second Amendment provides that the Company may reduce the conversion price of the Notes from time to time in order to incentivize the holders of the Notes to convert their Notes to common shares. In addition, at the Fourth Closing, holders of the Notes will be obligated to purchase at least 50% of the aggregate principal amount of the Note amounts they convert, either on a voluntary or installment conversion basis, on and after July 1, 2016, up to an aggregate amount of $6.25 million, although no holder will be obligated to purchase more Notes than originally scheduled in the First Amendment.

Description of the Notes

The Notes are payable in monthly installments, accrue interest at a rate of 7.0% per annum from the date of issuance and will mature 24 months after the First Closing, unless converted or redeemed earlier. The Notes may be repaid, at our election, in either cash or shares of our common stock at a discount to the then-current market price. The Notes are also convertible from time to time, at the election of the holders, into shares of our common stock at an initial conversion price of $4.35 per share. The conversion price was adjusted to $1.09 per share on January 29, 2016, the 16th trading day following the Reverse Stock Split, per the terms of the Notes.

The holder of each Note has the right to convert any portion of such Note unless the holder, together with its affiliates, beneficially owns in excess of 4.99% of the number of shares of our common stock outstanding immediately after giving effect to the conversion, as such percentage ownership is determined in accordance with the terms of the Notes. However, any holder may increase or decrease such percentage to any other percentage, but in no event above 9.99%, provided that any increase of such percentage will not be effective until 61 days after providing us notice.

The First Closing occurred on November 9, 2015. At the First Closing, we issued and sold Notes with an aggregate principal amount of $1.5 million, along with Warrants exercisable for 117,520 shares.

The Second Closing occurred on January 11, 2016 after we received approval of the offering by our stockholders and the satisfaction of certain customary closing conditions. At the Second Closing, we issued and sold Notes with an aggregate principal amount of $11.0 million, along with Warrants exercisable for 861,842 shares.

The Third Closing occurred on May 2, 2016 after we entered into the First Amendment and satisfied certain closing conditions. At the Third Closing, we issued and sold Notes with an aggregate principal amount of $6.25 million, along with Warrants exercisable for 489,684 shares.

At the Fourth Closing we will issue and sell Notes with an aggregate principal amount of up to $6.25 million, along with Warrants exercisable for 489,682 shares.

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the First Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at December 31, 2015	$ 65,217	$ 23,651	$ 88,868	56,967
Holder conversions during the quarter ended December 31, 2015	18,261	2,375	20,636	13,228
Balance, December 31, 2015	83,478	26,026	109,504	70,195
Installment amount at February 29, 2016	65,217	23,681	88,898	91,953
Installment amount at March 31,2016	65,217	14,827	80,044	88,960
Holder conversions during the quarter ended March 31, 2016	104,784	12,762	117,546	106,684
Balance, March 31, 2016	$318,696	$ 77,296	$395,992	357,792
Installment amount at April 30, 2016	65,217	13,853	79,070	101,764
Installment amount at May 31, 2016	65,217	13,082	78,299	148,467
Installment amount at June 30, 2016	54,217	11,275	65,492	251,320
Holder conversions during the quarter ended June 30, 2016	1,627	174	1,801	2,000
Balance, June 30, 2016	$504,974	$115,680	$620,654	861,343

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the Second Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at March 2, 2016	$ 404,762	$149,300	$ 554,062	*
Holder conversions during the quarter ended March 31, 2016	987,000	124,050	1,111,050	1,048,167
Balance, March 31, 2016	1,391,762	273,350	1,665,112	1,048,167
Installment amount at April 29, 2016	404,762	149,497	554,259	713,334
Installment amount at May 31, 2016	291,428	86,518	377,946	716,625
Installment amount at June 30, 2016	404,762	82,913	487,675	1,598,908
Holder conversions during the quarter ended June 30, 2016	25,373	2,995	28,368	29,000
Balance, June 30, 2016	$2,518,087	$595,273	$3,113,360	$4,106,034

The following table summarizes the installment amounts and additional conversions by the holders of the Notes issued at the Third Closing through June 30, 2016:

	Principal	Interest	Total	Common Shares
Installment amount at June 30, 2016	$212,158	$90,659	$302,817	$1,162,000
Balance, June 30, 2016	$212,158	$90,659	$302,817	$1,162,000

* Cash payments

Between July 1, 2016 and August 11, 2016 $2.6 million of aggregate principal amount of Notes were converted by holders of the Notes into approximately 14.1 million shares of the Company's common stock.

Description of the Warrants

Each Warrant is exercisable immediately and for a period of 60 months from the date of the issuance of the Warrant. Upon the completion of the Fourth Closing, the Warrants will entitle the holders of the Warrants to purchase, in aggregate, 1,958,728 shares of our common stock, subject to certain adjustments. The Warrants are initially exercisable at an exercise price equal to $4.65, subject to adjustment on the eighteen month anniversary of issuance, and certain other adjustments. The exercise price and number of shares of common stock issuable on the exercise of the Warrants is subject to adjustment upon the issuance of any shares of common stock or securities convertible into shares of common stock below the then-existing exercise price, with certain exceptions, and in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. The holder of each Warrant does not have the right to exercise any portion of such Warrant if the holder, together with its affiliates, beneficially owns in excess of 4.99% of the number of shares of the Company's common stock outstanding immediately after giving effect to the exercise, as such percentage ownership is determined in accordance with the terms of the Warrants. However, any holder may increase or decrease such percentage to any other percentage, but in no event above 9.99%, provided that any increase of such percentage will not be effective until 61 days after providing us notice.

The exercise price of the Warrants issued November 9, 2015 was reduced to $1.09 per share on January 29, 2016, the 16th trading day following the Reverse Stock Split, per the terms of the Warrants. The exercise price of the Warrants issued January 11, 2016 and May 2, 2016 remains $4.65 per share per the terms of the Warrants. All of the Warrants issued with the Notes remain subject to adjustment on the eighteen month anniversary of issuance.

Net Cash Used in Operating Activities

Net cash used in operating activities was $12.5 million and $11.2 million for the six months ended June 30, 2016 and 2015, respectively. Net cash used in operating activities primarily reflects the net loss for those periods, less noncash expenses for stock-based compensation, depreciation and amortization, change in value of convertible notes payable, change in value of warrant liability, and partially offset by changes in operating assets and liabilities.

Net Cash Used in Investing Activities

Net cash used in investing activities was $12,000 and $36,000 for the six months ended June 30, 2016 and 2015, respectively. Net cash used in investing activities for the six months ended June 30, 2016 and 2015 is attributable to the purchase of property and equipment.

Net Cash Provided by Financing Activities

Net cash provided by financing activities was $16.1 million and $4.4 million for the six months ended June 30, 2016 and 2015, respectively. Net cash provided by financing activities for the six months ended June 30, 2016 was due to $17.25 million in gross proceeds from the issuance of the Notes on January 11, 2016 and May 2, 2016, offset by $727,000 of debt issuance costs and principal repayments of $405,000 on the Notes. Net cash provided by financing activities for the six months ended June 30, 2015 was due to gross proceeds from "at-the-market" program draws of $6.7 million, offset by $2.0 million in principal repayments on our long-term debt and $228,000 in financing costs.

Operating Capital and Capital Expenditure Requirements

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the Maestro Rechargeable System, and have begun a controlled commercial launch at select centers in the United States. We had our first commercial sales within the United States in 2015 and for the year ended December 31, 2015 we recognized $292,000 in revenue. For the six months ended June 30, 2016

we recognized $348,000 in revenue. We anticipate that we will continue to incur net losses for the next several years as we develop our products, commercialize our Maestro Rechargeable System, develop the corporate infrastructure required to sell our products, operate as a publicly-traded company and pursue additional applications for our technology platform.

We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments. As of June 30, 2016, we had $11.5 million of cash and cash equivalents to fund our anticipated operations through 2016. On November 4, 2015 we entered into the Purchase Agreement with institutional investors to issue $25.0 million of Notes along with the accompanying Warrants. $1.5 million of the Notes was funded at the First Closing on November 9, 2015. An additional $11.0 million of the Notes was funded at the Second Closing on January 11, 2016 and $6.25 million more of the Notes was funded at the Third Closing on May 2, 2016, with the remaining $6.25 million to be funded at the Fourth Closing. Additionally, we have agreed that we will not, for a period of one year after the First Closing, issue any further securities, other than certain excluded securities. Our anticipated operations include plans that consider the controlled commercial launch of vBloc Therapy, delivered via the Maestro Rechargeable System, which was approved by the FDA on January 14, 2015. We believe that we have the flexibility to manage the growth of our expenditures and operations. In order to accelerate the execution of our business plans we may need to raise additional funds. Obtaining funds through the sale of additional equity and debt securities 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 for the year ended December 31, 2015. 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 Maestro Rechargeable System, we are unable to estimate the exact amounts of capital outlays and operating expenditures necessary to complete the development of the 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 Maestro Rechargeable System and any products that we may develop;
- the rate of market acceptance of our Maestro Rechargeable System and vBloc Therapy and any other product candidates;
- the cost and timing of obtaining adequate coding, coverage or payment levels for our Maestro Rechargeable System and vBloc Therapy by government healthcare programs and other third-party payors;
- 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 Maestro Rechargeable System or our 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;
- the cost of any recalls or other field actions required either by us or by regulatory bodies in those countries in which we market our products; 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

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities and expenses, as well as related disclosure of contingent assets and liabilities. In many cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on past experiences and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis.

During the six months ended June 30, 2016, 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, 2015.

Contractual Obligations

During the six months ended June 30, 2016, there were no material changes to our contractual obligation disclosures as set forth under the caption, "Contractual Obligations" in Part II, 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, 2015.

The following table summarizes our contractual obligations as of June 30, 2016 and the effect those obligations are expected to have on our financial condition and liquidity position in future periods:

	Payments Due By Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Operating lease	$536,533	$ 233,491	$303,042	$ —	$ —
Total contractual cash obligations	$536,533	$ 233,491	$303,042	$ —	$ —

The table above reflects only payment obligations that are fixed and determinable based on our current agreements. Our operating lease commitment relates to our corporate headquarters in St. Paul, Minnesota. The above table does not include the Notes due to the variability in timing and the option to settle the Notes through the issuance of shares.

Off-Balance Sheet Arrangements

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

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued *Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (Accounting Standards Update No. 2016-09 (ASU 2016-09))*. ASU 2016-09 modifies several aspects of the accounting for share-based payment awards, including income tax consequences, and classification on the statement of cash flows. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2016. We are currently evaluating the impact of adopting ASU 2016-09 on our consolidated financial statements.

In May 2014, FASB issued *Revenue from Contracts with Customers, Topic 606 (Accounting Standards Update No. 2014-09 (ASU 2014-09))*, which provides a framework for the recognition of revenue, with the objective that recognized revenues properly reflect amounts an entity is entitled to receive in exchange for goods and services. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2017. We are currently evaluating the impact of adopting ASU 2014-09 on our consolidated financial statements.

There have been no other significant changes in recent accounting pronouncements during the six months ended June 30, 2016 as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is confined to our cash and cash equivalents. As of June 30, 2016, we had $11.5 million in cash and cash equivalents. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk. To achieve our

goals, we may maintain a portfolio of cash equivalents and investments in a variety of securities of high credit quality. The securities in our investment portfolio, if any, are not leveraged, are classified as either available for sale or held-to-maturity and are, due to their very short-term nature, subject to minimal interest rate risk. We currently do not hedge interest rate exposure. Because of the short-term maturities of our cash equivalents, we do not believe that an increase in market rates would have any material negative impact on the value of our investment portfolio. We have no investments denominated in foreign currencies and therefore our investments are not subject to foreign currency exchange risk.

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 June 30, 2016, 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) were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not currently a party to any litigation and we are not aware of any pending or threatened litigation against us that could have a material adverse effect on our business, operating results or financial condition. The medical device industry in which we operate 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, we may be involved in various legal proceedings from time to time.

ITEM 1A. RISK FACTORS

There have been no material changes during the three months ended June 30, 2016 to the risk factors set forth in Part I, Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for the year ended December 31, 2015 and in Part II, Item 1A, *Risk Factors*, of our Quarterly Report on Form 10-Q for the Quarter ended March 31, 2016.

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

None.

ITEM 6. EXHIBITS

The list of exhibits on the accompanying Exhibit Index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ENTEROMEDICS INC.

BY: /S/ DAN W. GLADNEY

Dan W. Gladney
President and Chief Executive Officer
(Principal Executive Officer)

BY: /S/ GREG S. LEA

Greg S. Lea
Chief Financial
Officer and Chief Compliance Officer
(Principal Financial and Accounting Officer)

Dated: August 12, 2016

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1	Fifth Amended and Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-3 filed on May 9, 2014 (File No. 333-195855)).
3.2	Certificate of Amendment to Fifth Amended and Restated Certificate of Incorporation. (Incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on January 8, 2016 (File No. 1-33818)).
3.3	Certificate of Amendment to Fifth Amended and Restated Certificate of Incorporation. (Incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on January 8, 2016 (File No. 1-33818)).
3.4	Amended and Restated Bylaws of the Company, as currently in effect. (Incorporated herein by reference to Exhibit 3.4 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed on July 6, 2007 (File No. 333-143265)).
10.1*#	Exclusive Federal Government Business Channel Sales Agreement, effective April 25, 2016, by and between the Company and Academy Medical, LLC, as amended July 26, 2016.
10.2†	Form of Non-Incentive Stock Option Agreement for New Options granted June 27, 2016 pursuant to the option exchange offer. (Incorporated herein by reference to Exhibit (d)(6) to the Company's Tender Offer Statement under Section 14(d)(1) on Schedule TO filed on May 27, 2016).
10.3	Form of Amendment No. 2 to the Securities Purchase Agreement dated November 4, 2015, as amended by Amendment No.1 thereto dated May 2, 2016, among the Company and the buyers listed therein. (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 15, 2016 (File No. 1-33818)).
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 June 30, 2016, 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 Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash flows and (v) the Notes to Condensed Consolidated Financial Statements.

* Filed herewith.

† Indicates management contract or compensation plan or agreement.

Confidential portions of this exhibit (indicated by asterisks) have been omitted and filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request in accordance with Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

[**] Certain confidential information contained in this document, marked by brackets and asterisks, has been omitted and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

EXCLUSIVE FEDERAL GOVERNMENT RESELLER AND BUSINESS CHANNEL SERVICES AGREEMENT

WHEREAS, Enteromedics, Inc. ("**Manufacturer**"), with primary offices located in St. Paul, MN, produces and markets the products collectively listed in Exhibit A hereto ("**the Products**") to commercial and non-Government institutional customers;

WHEREAS, Academy Medical LLC ("**Reseller**"), a Service-Disabled Veteran-Owned Small Business located in West Palm Beach, Florida, has substantial experience in the establishment, operation and maintenance of effective sales channels, contract vehicles and business protocols to promote the sale of products to the United States Federal Government, with principal focus on Federal Government customers of medical products and supplies;

WHEREAS, Manufacturer now desires to engage Reseller as its exclusive Federal Government business channel partner to provide sales support services, customer liaison services, federal contract acquisition and management services, order processing services and other value added logistical support services to enable the sale of the Products to Federal Government customers; and

WHEREAS, Reseller now desires to accept Manufacturer's appointment as its exclusive Federal Government business channel partner to provide for the sale of the Products to Federal Government customers.

NOW THEREFORE, Manufacturer and Reseller hereby agree as follows effective this 25 day of April, 2016:

1. DEFINITIONS

A. The term "**Product**" means any product identified in Exhibit A. Product additions to Exhibit A may be made upon mutual agreement between Manufacturer and Reseller as may be required to fulfill the terms and obligations hereunder.

B. The term "**Customer**" means any entity authorized by law or contract to purchase products for use by Federal Government entities. Customers include the following:

i. All Federal Government entities accounts in the United States and U.S. Territories, including without limitation the United States Department of Defense, Department of Veterans Affairs, Department of Homeland Security, Indian Health Services, and Department of Health and Human Services and their respective sub-agencies and facilities; and

ii. All Prime Vendors or other parties authorized by contract or other written authorization to procure supplies on behalf of Federal Government entities;

C. The term "**Net Sales**" means the invoice price of the product purchased by Reseller from Manufacturer. Net Sales do not include (i) shipping, handling, freight charges, or insurance paid by or on behalf of Manufacturer in connection with shipment or delivery; or (ii) duties and taxes, or any other governmental charges levied on or measured by the invoiced amount, whether absorbed by the billing party or paid by the billed party.

D. The term "**Shipment Date**" means the date that Manufacturer ships any Manufacturer Product ordered by Reseller.

E. The term "**Term**" means the period of one(1) year from the date of execution of this Agreement during which time the terms of this Agreement shall be binding on all parties. This Agreement shall automatically renew each year thereafter for successive one (1) year periods (each renewal period defined as a "**Renewal Term**") unless this Agreement is earlier terminated as provided herein. All references in this Agreement to the "**Term**" shall refer to the "**Initial Term**" and all "**Renewal Terms**."

2. APPOINTMENT AS EXCLUSIVE RESELLER

A. Manufacturer hereby appoints Reseller as its exclusive representative for purposes of receiving and processing orders to sell the Products to Customers.

B. In furtherance of this Agreement, Reseller has or shall acquire and maintain appropriate contract vehicles to facilitate the sale of the Products to Customers. These contract vehicles will include Department of Veterans Affairs (VA) Federal Supply Schedule (FSS) contracts and Department of Defense (DOD) Distribution and Pricing Agreements (DAPA) or E-Catalog (E-Cat) contracts applicable to the Products.

C. The parties hereby agree and acknowledge that sales to the Customers may be accomplished by the following means:

i. Orders placed against FSS and VA Strategic Acquisition Center (SAC) contracts maintained by Reseller, as well as Blanket Purchase Agreements entered into under the terms of one or more FSS or SAC contracts maintained by Reseller;

ii. Orders placed against DOD DAPAs or E-Cat Contracts maintained by; and

iii. Open market orders placed by government Customers unrelated to a pre-existing contract; and

The parties agree that all such orders shall be processed for delivery and payment through Reseller.

D. To facilitate Reseller's acquisition and maintenance of appropriate contract vehicles, Manufacturer agrees to provide Reseller, upon request, with letters of commitment, product descriptions, price lists, commercial warranty terms, country of origin information and other information terms as may be requested of Reseller by Customers. Manufacturer further agrees to update and supplement this information when requested.

E. In establishing and maintaining contract vehicles for the Products, and accepting and processing orders for Products, Reseller expressly agrees to comply with any policy, terms, and conditions adopted by Manufacturer for the sale and distribution of the Product to commercial customers, including any policy concerning the distribution, handling, promotion, marketing, sale, resale, warranties, or returns of Manufacturer Products ("**Manufacturer Policies**"). Manufacturer shall provide Reseller with all such Manufacturer Policies within either fifteen (15) days of the execution of this Agreement or within fifteen (15) days of the addition of new Products under this Agreement.

F. Reseller expressly agrees to service all customer requirements in a commercially reasonable manner, subject to this Agreement's terms and conditions.

3. FEDERAL BUSINESS CHANNEL SERVICE TERM

A. **Pricing**

i. The pricing of Products under this Agreement reflect the price to be remitted to Manufacturer by Reseller in response to orders for Products placed by Customers. The initial prices for the Products are set forth in Exhibit A hereto.

ii. Such pricing is inclusive of the following:

(a) Packaging, boxing, palletizing, shipping, and storage in accordance with Manufacturer' standard practices in effect at the time of shipment;

(b) Special packing or handling established on individual orders as agreed to by Manufacturer at the time of order placement;

(c) Delivery to the Customer at the Customer's specified location; and

(d) All federal, state or local sale or excise taxes or other surcharges applicable to the Products.

iii. Manufacturer may increase prices under this Agreement provided that: (a) such price increases are consistent with price increases Manufacturer has established with its commercial distributors and resellers and (b) Reseller is provided ninety (90) days advance notice of such increases so as to affect pricing increases under its applicable contracts with government Customers. In the event that Reseller is unable to obtain a price increase for a Product under such contracts, the Parties agree that Reseller may delete the product from such contract.

B. **Order Processing**

i. Reseller maintains a robust e-commerce program for the placement and fulfillment of orders. Sales will be initiated by means of orders placed by Customers with Reseller. Upon receipt, Reseller will input the order into its e-commerce program for electronic transmission to Manufacturer. As Reseller typically has no more than five calendar days to acknowledge or decline such orders, Manufacturer shall acknowledge or decline all such orders within two calendar days or one business day, whichever is longer, of receipt of the order from Reseller. All orders not declined within these time limits will be deemed accepted by Manufacturer.

ii. Acceptance of an order transmitted by Reseller shall obligate Manufacturer to ship the product to the Customer within its standard delivery time as communicated to Reseller as a part of its Manufacturer policies. In the event that the Customer requires more rapid delivery of Product, Manufacturer will inform Reseller of the additional charges associated with the accelerated delivery requested by the Customer to enable Reseller to obtain Customer approval of such additional delivery charges.

iii. In the event delivery to the Customer will be delayed, Manufacturer shall promptly notify Reseller of the delay and the expected delivery date to enable Reseller to communicate the delay and revised delivery schedule to the customer. In the event the Customer elects to cancel an order because of a proposed delivery delay, the order shall be canceled at no cost to Reseller or the Customer.

iv. Upon shipment of product to the Customer, Manufacturer shall notify Reseller through Resellers e-commerce system to enable Reseller to confirm delivery to and acceptance by the Customer.

C. **Invoicing**. Manufacturer will invoice Reseller when Reseller Purchase Order is received and product is shipped. The invoice amount shall reflect the prices set forth in Exhibit A or any amendments thereto, and any special shipping charges agreed to by the Customer.

D. **Payment Terms**. Terms of payment will be Net 30 from date of invoice, unless Customer has declined acceptance of Product or has voiced other concerns related to the Product.

The terms set forth in this Agreement shall apply to each order by a Reseller, whether such order is communicated by telephone, facsimile, or through electronic order entry, or any other method, or whether reference is made to this Agreement.

E. **Shipping**. Manufacturer shall be responsible for selecting the method of shipment and all associated freight costs thereon be included in pricing attached in Exhibit A., except that emergency or overnight shipment requests by Customer will be paid by Reseller after confirmation of the additional shipping costs by the Customer.

F. **Production**. Manufacturer shall not be excused from performance under this Agreement in the event acts which may frustrate the purpose of this Agreement or ability to perform under its terms, provided such acts are within Manufacturer control. Additionally, if production, delivery, or distribution is delayed for any reason not the fault of Reseller, Manufacturer shall take all reasonable measures to assure fulfillment and shall be solely liable for any additional costs of fulfillment and the costs of capital. Manufacturer shall, at all times, maintain a plan for continued performance under this contract in the face of delays or impediments to fulfillment due to acts of God and shall, upon receipt of request from Reseller, provide Reseller with specifics of said plan for which Reseller may inspect and become familiar, but in the event such acts impair Manufacturer's ability to perform, Manufacturer will be excused from performance.

G. **Reseller's Representations & Continuing Obligations**

i. Reseller hereby represents and warrants to Manufacturer that (i) neither its entering nor performing this Agreement will violate any right of or breach any obligation to any third party under any agreement or arrangement between Reseller and such third party, (ii) Reseller has all licenses, permits, authorizations and approvals that are necessary for the conduct of its business in the Territory; and (iii) neither this Agreement (or any term hereof) nor the performance of or exercise of rights under this Agreement by either Party is contrary to, in conflict with, ineffective under, or violates any applicable law or regulation including, without limitation, the federal anti-kickback statute (42 U.S.C. §1320a-7b(b)(2)), the federal prohibition on self-referrals or Stark Law (42 U.S.C. §1395nn), or any other similar federal or state statute or any applicable regulations promulgated thereunder.

ii. Reseller shall not make any claims or representations concerning the Products that are inconsistent with those made by Manufacturer.

H. **Manufacturer's Continuing Obligations**

i. Manufacturer agrees to send all Product notices, as well as notices of any other changes affecting the Products and notices of new Products, to Reseller. Manufacturer shall notify Reseller, in writing and no later than the date of execution of this Agreement, of the names of those Products which contain latex, carcinogens, DEHP or 2 di-ethyl hexyl phthalate, halogenated organic flame retardants, lead, mercury, persistent bioaccumulative toxins, PVC or polyvinyl chloride, reproductive toxins and any Product(s) designed specifically for pediatric applications.

ii. Manufacturer shall notify Reseller in writing and within three (3) days after becoming aware of any patient safety issue involving the Products. If any Product or any of its components is subject to recall as that term is defined under 21 C.F.R. Part 7, or a voluntary recall by Manufacturer or is subject to an FDA-initiated court action for removing or correcting violative, distributed products or components (any of the foregoing being referred to as a "**Recall**"), Manufacturer shall notify Reseller within twenty-four (24) hours after becoming aware of any such recall or after Manufacturer provides notice of the Recall to the FDA. To the extent any such Recall precludes Manufacturer from supplying any Products under this Agreement, any compliance requirements or purchase requirements under this Agreement or any facility agreement between any Reseller and Manufacturer related to such Products shall not be effective for as long a Manufacturer is unable to supply such Products. If any Product pricing is dependent upon Reseller meeting compliance or purchase volume requirements for designated Products, Reseller pricing will not change for failure to meet the compliance or purchase requirements during the time period when Manufacturer is unable to provide said designated Products.

I. **Returns**. Reseller shall have the right to return to Manufacturer any Product that does not comply with the warranties expressed herein. Furthermore, Reseller shall have the right to return to Manufacturer Products or any components therein which are subject to a Recall, regardless of whether actual return of the Products or components to Manufacturer is required, recommended, or suggested by the Recall, in which case Manufacturer shall pay all freight costs incurred for the return of each affected Product and shall reimburse Reseller for original costs, including freight, in acquiring each affected Product.

J. **Resale Prices**. Reseller may set the resale prices for any Manufacturer Product purchased from Manufacturer pursuant to this Agreement. By signing this Agreement, Reseller unequivocally acknowledges that it has not, and will not, enter into any written or oral agreement with Manufacturer concerning the amount that Reseller charges to its customers for any Manufacturer Product. Nothing in this Agreement shall prevent Manufacturer from unilaterally adopting, announcing, and following any resale pricing policy, suggested resale pricing policy, or minimum advertised pricing policy.

4. TRADEMARK USAGE & INTELLECTUAL PROPERTY

A. Reseller shall have the limited right to use the trademarks, service marks and trade names associated with the Products in marketing the Products in the Territory, subject to Manufacturer's prior written authorization of all such use, and where the Trademark is registered and a "TM" elsewhere. This limited right is limited to the Territory.

B. All use of the Manufacturer intellectual property, including without limitation any goodwill arising there from shall inure to Manufacturer's sole benefit.

C. Reseller agrees not to register, attempt to register or use or attempt to use, directly or indirectly, any trademark, service mark or trade names that are confusingly similar to Manufacturer.

D. Manufacturer agrees that it shall be solely liable for the protection of the intellectual property rights that arise under this Agreement and the intellectual property rights of third parties in fulfilling the terms of this Agreement.

5. TERMINATION

A. This Agreement may be terminated for cause by either party or without cause by each respective party as provided below:

1. Termination for Cause by Either Party: Either party hereto may terminate this Agreement, with cause as follows:
    a. The failure of the non-terminating party to fail to perform any of the obligations in this Agreement (unless such failure is caused by a material act or omission by the other party) and such failure shall continue for a period of thirty (30) days after written notice thereof;

b. The non-terminating party shall become insolvent, file a voluntary petition under any law relating to bankruptcy or insolvency, or shall become unable to pay its debts when due; or

c. The exclusion of the non-terminating party from participation in federal health care programs or their suspension or debarment from federal contracting programs.

2. Termination without Cause by Manufacturer: Manufacturer may terminate this Agreement, without cause, upon providing sixty (60) days' written notice to Reseller prior to the expiration of the Initial Term or any Renewal Term, subject to the following:

a. If Manufacturer terminates this Agreement without cause prior to, during, or after the first Renewal Term, Manufacturer shall pay to Reseller a Fee of ten percent (10%) of the gross sales of the Products distributed by Reseller for the immediately preceding twelve (12) months.

b. If Manufacturer asserts a termination for cause that is later determined to have been without cause, the above termination fees shall be owed by Manufacturer to Reseller.

3. Termination without Cause by Reseller: Reseller may terminate this Agreement, without cause, upon providing one hundred eighty (180) days' notice to Manufacturer prior to its desired termination date, or the expiration date of the initial Term or any Renewal Term, which ever period is longer.

The effective date of the termination shall be the later of the date specified in the termination notice specified by this paragraph or 30 days following such notice (the "**Termination Date**").

B. Upon notice of termination, Reseller may not make additional purchases from Manufacturer during the (30) day notice period, except in an amount not exceeding the average monthly purchase for the preceding three months prior to the notice of termination. Reseller shall not resell any Manufacturer Product to any person or entity for any reason after the Termination Date.

C. For the purposes of this Agreement, notices, demands and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been properly given when delivered in person or by courier or three (3) days after mailed by United States certified or registered mail, return receipt requested, postage prepaid, addressed as follows:

If to Manufacturer:	Enteromedics 2800 Patton Road St. Paul, MN 55113
If to Reseller:	Academy Medical, LLC 8120 Belvedere Rd. #3 W. Palm Beach, FL 33411

or to such other address as any party may have furnished to the other in writing in accordance herewith, except that notices of change of address shall be effective only upon receipt.

6. INDEMNIFICATION

A. Except as to negligent acts of the Reseller, Manufacturer shall defend and indemnify Reseller from and against all suits, claims, liabilities, fines, expenses, damages, penalties, judgments, reasonable attorneys' fees, and expenses arising out of or related to any (i) failure by Manufacturer to comply with applicable statutory or regulatory requirements, (ii) Product defect, or (iii) Product recall, (iv) Manufacturer's infringement of third-party patent and misappropriation of third party intellectual property rights, or (iv) any alleged injury suffered by an end-user of the Product arising out of, incident, related to Reseller's fitting of, treatment of, or written instructions regarding Product use to the end-user pursuant of Manufacturer recommendations of use.

B. Reseller shall defend and indemnify Manufacturer from and against all suits, claims, liabilities, fines, expenses, damages, penalties, judgments, reasonable attorneys' fees, and expenses arising out of or related to (i) any negligent or intentional act or omission of Reseller or any employee, officer, director, shareholder, affiliate or other person engaged or hired by Reseller, including but not limited to any material breach of this Agreement by Reseller, or by any of its employees, officers, directors, shareholders, affiliates or other persons engaged or hired by Reseller, (ii) the making of any representations or warranties by Reseller with respect to the Products not expressly authorized by this Agreement or by Manufacturer in writing, or (iii) the infringement by Reseller of the intellectual property or other proprietary rights of any third party, or the violation or misappropriation of any of the proprietary rights of Manufacturer.

7. ADDITIONAL TERMS

A. **Compliance with Laws**. Each party agrees to comply with all applicable Federal laws affecting this Agreement and its performance, and any similar state laws and regulations. Each party shall obtain and maintain all registrations with governmental agencies, commercial registries, or any other offices that may be required under local law to perform its obligations under this Agreement.

B. **Non-compete**. By signing this Agreement, Reseller affirms that it is not bound by any non-compete or other contractual arrangements that would prevent it from selling the Products, or otherwise complying with the terms of this Agreement.

C. **Insurance**. Manufacturer agrees to maintain adequate and appropriate insurance coverage throughout the term of this Agreement at its own expense for (i) commercial general liability insurance for bodily injury, death and property loss (ii) product liability policy with limits of liability in the minimum amount of five hundred thousand dollars ($500,000) per occurrence and 3 million dollars ($3,000,000) in the annual aggregate. Manufacturer agrees to apply coverage to Reseller for claims, lawsuits or damages arising out of Manufacturer performance under this Agreement. Manufacturer shall provide Reseller with a certificate of insurance naming Reseller as an additional insured on its product liability policy prior to the execution of this Agreement. Reseller shall have no obligation to obtain or maintain such insurance. Reseller agrees to maintain adequate and appropriate insurance coverage throughout the term of this Agreement at its own expense for (i) property loss associated with the consigned inventory. Reseller shall provide Manufacturer with a certificate of insurance naming Manufacturer as a loss payee on its property insurance associated with the consigned inventory.

D. **Jurisdiction and Dispute Resolution**. This Agreement shall be governed by Delaware law, excluding its conflict of law principles. Any action arising out of or relating to this Agreement shall be brought exclusively in the federal and state courts located in Delaware. The prevailing party in any arbitration or suit shall be entitled to its reasonable attorney fees.

8. MISCELLANEOUS

A. **Interpretation**. The parties acknowledge that each has had an opportunity to have its counsel review and revise this Agreement and that any rule of law or legal decision that would require interpretation of any claimed ambiguity against the party drafting it shall have no application to this Agreement and is expressly waived. The provisions of this Agreement shall be interpreted in a reasonable manner to effectuate the intent of the parties.

B. **Entire Agreement**. Amendment. This Agreement contains the entire agreement of the parties, and supersedes any other existing agreements, representations or promises regarding the same subject matter, whether verbal or written. This Agreement may not be modified except through a writing that is signed by both parties.

C. **Binding Effect**. No Assignment. This Agreement is binding upon and inures to the benefit of the parties, their respective heirs, executors, administrators, successors and assigns. Neither party may assign this Agreement or subcontract any of its obligations without the prior written consent of the other party, which consent may not be unreasonably withheld.

D. **Waiver of Breach**. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion is not considered a waiver of said term, nor does it deprive such party of the right thereafter to enforce said term or any other term of this Agreement.

E. **Severability**. If any provision of this Agreement is found to be invalid or illegal for any reason whatsoever, then notwithstanding such invalidity or illegality, the remaining terms and provisions of this Agreement will remain in full force and effect in the same manner as if the invalid or illegal provisions had not been contained herein.

F. **Counterparts**. Facsimile Signatures. This Agreement may be executed in multiple counterparts and so executed will constitute one agreement, binding on all parties, even though all parties are not signatories to the original or same counterpart. Any counterpart of this Agreement will for all purposes be deemed a fully executed instrument. Facsimile signatures shall be as effective as original signatures.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

Enteromedics, Inc.	**Academy Medical, LLC**
/s/ Greg Lea	/s/ W. Kirkland Alexander
Name: Greg Lea	Name: W. Kirkland Alexander
Title: Chief Financial Officer	Title: Chief Operating Officer
Date:	Date: 5/6/2016

Exhibit A – PRODUCTS AND PRICING

[**]

[**] Certain confidential information contained in this exhibit, marked by brackets and asterisks, has been omitted and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

Exhibit B – MSPV REPRESENTATION DISTRIBUTORSHIP AGREEMENT

This Agreement is made effective April 25, 2016 ("**Effective Date**") by and between Enteromedics, Inc. ("**Company**") and Academy Medical, LLC, a Florida limited liability company ("**Distributor**"). The Company and Distributors are sometimes referred to as the "**Parties**", and each individually is a "**Party**".

For Distributor to contract with various Medical Surgical Prime Vendors (MSPVs), Company makes the additional representations and gives Distributor permission to make such representations on its behalf for the purposes of contracting with various MSPVs.

Company and Distributor hereby acknowledge that their Distributorship Agreement ("**Agreement**") dated April 25, 2016, is hereby amended as follows to add the following representations.

1. Company representations. Company represents, warrants and covenants:

a. Company has the full right, power, and corporate authority to enter into this Agreement and to make the promises set forth in this Agreement, and there are no outstanding agreements, assignments, licenses, liens or encumbrances of any kind in existence that are either inconsistent with the provisions of this Agreement or would affect Company's ability to perform its obligations hereunder.

b. No actions are threatened or pending before any court, Governmental Authority, or other tribunal of any kind, relating to the Product that would affect Company's ability to perform its obligations hereunder. For purposes of this Agreement, "**Governmental Authority**" shall mean any supranational, national, provincial, regional, state, or local governmental or regulatory authority, agency, or other body with regulatory or legal jurisdiction over Company and/or the manufacture and sale of the Products, in the form of laws, statutes, regulations, or guidance documents; including but not limited to the United States FDA and Health Canada.

c. Company affirms that Products do not infringe on the intellectual property rights of any third party.

d. That Company, its employees, agents or representatives performing services or supplying Products, parts, or raw materials in connection with the Products and/or this Agreement, are not now nor have ever been: (i) convicted of a criminal offense related to health care; or (ii) excluded, debarred, or otherwise ineligible for participation in a U.S. "Federal health care program" as defined in 42 U.S.C. §1320a-7b(f) (or any applicable successor statutory section) or in any other government payment program. Company hereby further certifies that it will immediately notify Academy Medical upon its receipt of any indication, whether or not official, that Company, its employees, agents or representatives performing services or supplying Products, parts, or raw materials in connection with the Products and/or this Agreement, shall be excluded from any U.S. Federal health care program, as defined above, for any reason during the Term. Company further certifies to Academy Medical that (i) to the best of its knowledge, it has no knowledge of any circumstances which may affect the accuracy of the foregoing representations, including, without limitation, FDA investigations of, or debarment proceedings against Company or any person or entity performing services or rendering assistance which is in any way related to activities taken pursuant to this Agreement; and (ii) Company will immediately notify Academy Medical in writing, via certified or registered mail, if it becomes aware of any such circumstances described in this Section at any time during the Term.

e. That all Product claims that it makes with respect to the Products in its advertising and marketing materials, including any Product claims which are reviewed and approved by Company at Academy Medical's requests conform to all current federal and state regulations, based on FDA submissions and all regulatory

considerations that may be applicable to the Product. Company is responsible for assuring that all claims, features, specifications, technical details and benefits are stated without exaggeration and with fair balance and truthfully reflect the capabilities of the Product. If applicable, Company will have appropriate substantiation on file to support Product claims.

f. The Products will comply with the provisions set forth in the Continuing Guaranty attached hereto as Schedule A, the terms and conditions of which are made part hereof to the extent consistent with the terms set out in the body of this Agreement.

No other portion of the Agreement is modified.

IN WITNESS HEREOF, the Parties hereto have executed this Agreement effective as of the Effective Date.

COMPANY: Enteromedics, Inc.

By: /s/ Greg Lea
Name: Greg Lea
Title: Chief Financial Officer

DISTRIBUTOR: Academy Medical, LLC
A Florida Limited Liability Company

By: /s/ W. Kirkland Alexander
Name: W. Kirkland Alexander
Title: Chief Operating Officer

Schedule A– CONTINUING GUARANTY

1. Compliance with Laws and Product Warranty: Company specifically represents, warrants, and guarantees that each product shipped, (A) as of the date of shipment: (i) is not adulterated or misbranded within the meaning of the U.S. Federal Food, Drug, and Cosmetic Act, as amended and the regulations issued thereunder ("**Act**"); (ii) is free from defects in design, workmanship and materials, and (iii) has been manufactured, packaged, labeled, and stored in compliance and in accordance with: (a) the applicable product specifications, including not containing any material other than those specifically listed in the product specification; and (b) all applicable local, state, federal and national laws, regulation, rules, guidelines and procedures, including but not limited to the Act and standards relating to current good manufacturing practices for the products; and (B) will as of the date of shipment and continuing until the expiration date of each product (as indicated on the product's label or inserts) or useful life, if the product does not have an expiration date: (i) conform to the applicable product specifications, and (ii) meet or exceed the claims made by the Company for the products. Company shall provide Academy Medical with additional certifications of Company's compliance with the representations and warranties set forth herein as Academy Medical may from time to time reasonably request to fulfill its obligations as a government contractor.

2. Indemnification: Company agrees to defend, indemnify and hold harmless Academy Medical, its directors, officers, employees, representatives, agents and/or affiliated entities from any liability, loss, expense, cost, claim or judgment (including attorney fees), arising out of: (A) any claim where the product is alleged to have caused or contributed to the damages, injuries or death, provided that this indemnification does not extend to injuries, damages or death to the extent caused by gross negligence or reckless disregard on the part of Academy Medical or any of its employees; (B) a breach of any representation, warranty, or covenant in any product and/or distribution agreement between Academy Medical and Company; and (C) any claim that the products infringe the patent, trademark or other proprietary rights of any other party.

3. Corrective Actions and Product Complaints: Notwithstanding any provision in any agreement to the contrary, if Company's product is subject to a product corrective action (including field corrective action, recall, destruction, or hold), and provided the product corrective action was not caused by Academy Medical's gross negligence, recklessness, or willful misconduct, then Company shall be responsible for reimbursing Academy Medical for all costs and expenses associated with the product corrective action, including, but not limited to: inspection, testing, market withdrawal, communications, labor, shipping, transportation, penalties, fines, and the replacement costs of finished goods and work-in-process in which Company's product was included and/or incorporated. Company shall be responsible for notifying the appropriate federal, state and local authorities of any customer complaints or other occurrences regarding the Products which are required to be so reported, evaluating all complaints and responding to Academy Medical in writing on the resolution of any complaints from Academy Medical or its customers.

4. Survival of Guaranty: This guaranty shall be continuing and shall be binding upon the Company and his or its heirs, executors, administrators, successors and/or assigns and shall inure to the benefit of Academy Medical, its successors and assigns and to the benefit of its officers, directors, agents and employees.

Effective Date: April 25, 2016

COMPANY: Enteromedics, Inc.

By: /s/ Greg Lea
Name: Greg Lea
Title: Chief Financial Officer

[**] Certain confidential information contained in this document, marked by brackets and asterisks, has been omitted and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

MODIFICATION TO
RESELLER AND BUSINESS CHANNEL SERVICES AGREEMENT
DATED APRIL 25, 2016

This modification Agreement is made effective July 26, 2016 ("Effective Date") by and between Enteromedics, Inc. ("Company") and Academy Medical, LLC, a Florida limited liability company ("Distributor"). The Company and Distributors are sometimes referred to as the "Parties", and each individually is a "Party".

Company and Distributor hereby acknowledge that their Reseller and Business Channel Services Agreement ("Agreement") dated April 25, 2016, is hereby amended as follows.

1. "Exhibit A" is replaced with "Exhibit A Revised 07/26/2016" below.

No other portion of the Agreement is modified.
IN WITNESS HEREOF, the Parties herto have executed this Agreement effective as of the Effective Date.

COMPANY: Enteromedics, Inc.

By: /s/ Greg Lea
Name: Greg Lea
Title: Chief Financial Officer

DISTRIBUTOR: Academy Medical, LLC
A Florida Limited Liability Company

By: /s/ W. Kirkland Alexander
Name: W. Kirkland Alexander
Title: Chief Operating Officer

EnteroMedics, Inc.
Negotiated Pricing GOVERNMENT DISTRIBUTOR AGREEMENT
Currency – USD

[**]

[**] Certain confidential information contained in this exhibit, marked by brackets and asterisks, has been omitted and filed separately, accompanied by a confidential treatment request, with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

Exhibit 31.1

CERTIFICATION

I, Dan W. Gladney, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics 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/ DAN W. GLADNEY

Dan W. Gladney
President and Chief Executive Officer

Date: August 12, 2016

Exhibit 31.2

CERTIFICATION

I, Greg S. Lea, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics 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/ GREG S. LEA

Greg S. Lea
Chief Financial Officer
and Chief Compliance Officer

Date: August 12, 2016

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), Dan W. Gladney, in his capacity as Chief Executive Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016 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 EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /s/ DAN W. GLADNEY

Dan W. Gladney
President and Chief Executive Officer

Date: August 12, 2016

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), Greg S. Lea, in his capacity as Chief Financial Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016 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 EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /s/ GREG S. LEA

Greg S. Lea
Chief Financial Officer
and Chief Compliance Officer

Date: August 12, 2016