DELCATH SYSTEMS, INC.
Form 10-Q
November 14, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ____________

Commission File Number: 001-16133

DELCATH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	06-1245881
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1633 Broadway, Suite 22C

(Address of principal executive offices)

(212) 489-2100

(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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer" "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act .

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

As of November 13, 2017, 2,591,509 shares of the Company's common stock, $0.01 par value, were outstanding.

DELCATH SYSTEMS, INC.

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DELCATH SYSTEMS, INC.

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	September 30, 2017 (Unaudited)	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$ 2,495	$ 4,409
Restricted cash	8,362	27,287
Accounts receivables, net	298	403
Inventories	1,164	660
Prepaid expenses and other current assets	385	698
Deferred financing costs	529	699
Total current assets	13,233	34,156
Property, plant and equipment, net	1,253	1,083
Total assets	$ 14,486	$ 35,239
Liabilities and Stockholders' Deficit		
Current liabilities		
Accounts payable	$ 1,891	$ 594
Accrued expenses	3,755	3,407
Series C preferred shares	494	—
Convertible notes payable, net of debt discount	9,736	13,343
Warrant liability	16	18,751
Total current liabilities	15,892	36,095
Deferred revenue	—	30
Other non-current liabilities	444	604
Total liabilities	16,336	36,729
Commitments and Contingencies	—	—
Stockholders' deficit		
Preferred stock, $.01 par value; 10,000,000 shares authorized; no shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	—	—
Common stock, $.01 par value; 500,000,000 shares authorized; 1,426,153 and 11,805 shares issued and 1,425,862 and 11,750 shares outstanding at September 30, 2017 and December 31, 2016, respectively*	14	—
Additional paid-in capital	303,808	277,790
Accumulated deficit	(305,587)	(279,188)

Treasury stock, at cost; 1 share at September 30, 2017 and December 31, 2016, respectively*	(51)	(51)
Accumulated other comprehensive income	(34)	(41)
Total stockholders' deficit	(1,850)	(1,490)
Total liabilities and stockholders' deficit	$ 14,486	$ 35,239

*reflects a one-for-sixteen (1:16) reverse stock split effected on July 21, 2016 and a one-for-three hundred and fifty (1:350) reverse stock split effected on November 6, 2017

See accompanying Notes to Condensed Consolidated Financial Statements.

DELCATH SYSTEMS, INC.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

(in thousands, except share and per share data)

	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
Revenue	$684	$435	$2,011	$1,316
Cost of goods sold	172	112	527	373
Gross profit	512	323	1,484	943
Operating expenses:				
Selling, general and administrative	2,860	2,361	7,807	7,025
Research and development	2,279	2,686	7,119	5,975
Total operating expenses	5,139	5,047	14,926	13,000
Operating loss	(4,627)	(4,724)	(13,442)	(12,057)
Change in fair value of the warrant liability, net	27	8,680	1,227	9,171
Gain on warrant extinguishment	—	—	9,613	—
Loss on debt settlements	(2,952)	—	(2,952)	—
Interest expense	(5,042)	(4,963)	(20,324)	(6,584)
Other income (expense)	(2)	3	5	(15)
Net loss	$(12,596)	$(1,004)	$(25,873)	$(9,485)
Other comprehensive loss:				
Foreign currency translation adjustments	(15)	(2)	7	(12)
Comprehensive loss	$(12,611)	$(1,006)	$(25,866)	$(9,497)
Common share data:				
Basic and diluted loss per share*	$(9.36)	$(230.99)	$(34.99)	$(2,232.30)
Weighted average number of basic and diluted common shares outstanding*	1,401,413	4,349	754,421	4,249

*reflects a one-for-sixteen (1:16) reverse stock split effected on July 21, 2016 and a one-for-three hundred and fifty (1:350) reverse stock split effected on November 6, 2017

See accompanying Notes to Condensed Consolidated Financial Statements.

DELCATH SYSTEMS, INC.

Condensed Consolidated Statements of Stockholders' Deficit)

(Unaudited)

(in thousands, except share data)

	Common Stock Issued $0.01 Par Value		Treasury Stock				Accumulated Other Comprehensive	
	No. of Shares	Amount	No. of Shares	Amount	Additional Paid in Capital	Accumulated Deficit	loss	Total
Balance at January 1, 2017	11,805	$ —	(1)	$ (51)	$ 277,790	$ (279,188)	$ (41)	$ (1,490)
Compensation expense for issuance of stock options	—	—	—	—	48	—	—	48
Compensation expense for issuance of restricted stock	261	—	—	—	84	—	—	84
Issuance of common stock for payments made in shares on convertible note payable	1,413,790	14	—	—	25,852	—	—	25,866
Series B preferred stock dividend						(526)		(526)
Warrants exercised	297	—	—	—	15	—	—	15
Fair value of warrants exercised		—	—	—	19	—	—	19
Net loss	—	—	—	—	—	(25,873)	—	(25,873)
Total comprehensive loss	—	—	—	—	—	—	7	7
Balance at September 30, 2017	1,426,153	$ 14	(1)	$ (51)	$ 303,808	$ (305,587)	$ (34)	$ (1,850)

*reflects a one-for-sixteen (1:16) reverse stock split effected on July 21, 2016 and a one-for-three hundred and fifty (1:350) reverse stock split effected on November 6, 2017
See accompanying Notes to Condensed Consolidated Financial Statements.

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DELCATH SYSTEMS, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	Nine months ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net loss	$(25,873)	$(9,485)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock option compensation expense	48	138
Restricted stock compensation expense	84	228
Depreciation expense	198	232
Loss on disposal of equipment	20	1
Warrant liability fair value adjustment	(1,227)	(9,171)
Gain on warrant extinguishment	(9,613)	—
Non-cash interest income	16	(1)
Deferred revenue	(30)	31
Debt discount and deferred finance costs amortization	20,315	6,567
Loss on debt settlements	2,952	—
Changes in assets and liabilities:		
Decrease in prepaid expenses and other assets	276	610
Increase in accounts receivable	(94)	(94)
Decrease (increase) in inventories	(338)	190
Increase in accounts payable and accrued expenses	1,767	312
Decrease in other non-current liabilities	(160)	(155)
Net cash used in operating activities	(11,659)	(10,597)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(372)	(245)
Increase in restricted cash	—	(1,087)
Net cash used in investing activities	(372)	(1,332)
Cash flows from financing activities:		
Increase in restricted cash	—	(29,200)
Net proceeds from the release of restricted cash	7,901	—
Release of restricted cash for extinguishment of Series C Warrants	7,876	—
Cash paid to extinguish of Series C Warrants	(7,876)	—
Net proceeds from sale of Series B and Series C preferred shares	2,278	—
Release of restricted cash for redemption of Series A and Series B preferred shares	2,360	—
Redemption of Series A and Series B preferred shares	(2,360)	—
Net proceeds from convertible debt financing	—	31,436
Net proceeds from sale of stock and exercise of warrants	15	704
Net cash provided by financing activities	10,194	2,940
Foreign currency effects on cash and cash equivalents	(77)	71

Net decrease in cash and cash equivalents	(1,914)	(8,918)
Cash and cash equivalents:		
Beginning of period	4,409	12,607
End of period	$2,495	3,689
Supplemental non-cash activities:		
Conversion of convertible notes to common stock	$26,199	$—
Fair value of warrants issued	$—	$28,133
Fair value of warrants exercised	$19	$245

See accompanying Notes to Condensed Consolidated Financial Statements.

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DELCATH SYSTEMS, INC.

Notes to the Condensed Consolidated Financial Statements

(1) General

The interim condensed consolidated financial statements of Delcath Systems, Inc. (“Delcath” or the “Company”) as of and for the three and nine months ended September 30, 2017 and 2016 should be read in conjunction with the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (“Annual Report”), which has been filed with the Securities Exchange Commission (“SEC”), as amended by that certain Amendment No. 1 to Form 10-K for the year ended December 31, 2016, filed with the SEC on July 14, 2017 and can also be found on the Company’s website (www.delcath.com). In these notes the terms “us”, “we” or “our” refer to Delcath and its consolidated subsidiaries.

On November 6, 2017, the Company effected a reverse stock split at which time Delcath’s common stock began trading on the OTCQB on a one-for-three hundred and fifty (1:350) split-adjusted basis. All owners of record as of the open of the OTCQB market on November 6, 2017 received one issued and outstanding share of Delcath common stock in exchange for three hundred and fifty issued and outstanding shares of Delcath common stock. No fractional shares were issued in connected with the reverse stock split. All fractional shares created by the one-for-three hundred and fifty exchange were rounded up to the next whole share. The reverse stock split had no impact on the par value per share of Delcath common stock, which remains at $0.01. All current and prior period amounts related to shares, share prices and earnings per share, presented in the Company’s interim condensed consolidated financial statements contained in the Quarterly Report on Form 10-Q and the accompanying Notes, have been restated to give retrospective presentation for the reverse stock split.

Description of Business

Delcath Systems, Inc. is an interventional oncology company focused on the treatment of primary and metastatic liver cancers. Our investigational product—Melphalan Hydrochloride for Injection for use with the Delcath Hepatic Delivery System (Melphalan/HDS) —is designed to administer high-dose chemotherapy to the liver while controlling systemic exposure and associated side effects. In Europe, our system is in commercial development under the trade name Delcath Hepatic CHEMOSAT® Delivery System for Melphalan (CHEMOSAT®), where it has been used at major medical centers to treat a wide range of cancers of the liver.

Our primary research focus is on ocular melanoma liver metastases (mOM) and intrahepatic cholangiocarcinoma (ICC), a type of primary liver cancer, and certain other cancers that are metastatic to the liver. We believe the disease states we are investigating represent a multi-billion dollar global market opportunity and a clear unmet medical need.

Our clinical development program for CHEMOSAT and Melphalan/HDS is comprised of The FOCUS Clinical Trial for Patients with Hepatic Dominant Ocular Melanoma (The FOCUS Trial), a Global Phase 3 clinical trial that is investigating overall survival in mOM, and a registration trial for intrahepatic cholangiocarcinoma (ICC) we plan to initiate in 2017. Our clinical development plan (CDP) also includes a commercial registry for CHEMOSAT non-clinical commercial cases performed in Europe and sponsorship of select investigator initiated trials (IITs) in colorectal cancer metastatic to the liver (mCRC) and pancreatic cancer metastatic to the liver.

Liquidity and Operating Matters

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred losses since inception and has an accumulated deficit of $305.6 million at September 30, 2017. As shown in the accompanying financial statements during the three and nine months ended September 30, 2017, the Company incurred net losses of $12.6 million and $25.9 million, respectively and during the nine months ended September 30, 2017 used $11.7 million of cash for its operating activities. These factors among others raise substantial doubt about the Company’s ability to continue as a going concern for a reasonable period of time.

The Company’s existence is dependent upon management’s ability to obtain additional funding sources or to enter into strategic alliances. There can be no assurance that the Company’s efforts will result in the resolution of the Company’s liquidity needs. The accompanying statements do not include any adjustments that might result should the Company be unable to continue as a going concern.

The Company has incurred losses since inception. The Company anticipates incurring additional losses until such time, if ever, that it can generate significant sales. As a result of issuing $35.0 million in senior secured convertible notes in June 2016 and effecting a reverse stock split on November 6, 2017 management believes that in its current reduced operating mode its capital resources will be adequate to fund operations through at least January 2018. To the extent additional capital is not available when needed, the Company may be forced to abandon some or all of its development and commercialization efforts, which would have a material adverse effect on the prospects of the business. Operations of the Company are subject to certain risks and uncertainties, including, among others, uncertainties and risks related to clinical research, product development; regulatory approvals; technology; patents and proprietary rights; comprehensive government regulations; limited commercial manufacturing; marketing and sales experience; and dependence on key personnel.

Basis of Presentation

These interim condensed consolidated financial statements are unaudited and were prepared by the Company in accordance with generally accepted accounting principles in the United States of America (GAAP) and with the SEC's instructions to Form 10-Q and Article 10 of Regulation S-X. They include the accounts of all entities controlled by Delcath and all significant inter-company accounts and transactions have been eliminated in consolidation.

The preparation of interim financial statements requires management to make assumptions and estimates that impact the amounts reported. These interim condensed consolidated financial statements, in the opinion of management, reflect all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the Company's results of operations, financial position and cash flows for the interim periods ended September 30, 2017 and 2016; however, certain information and footnote disclosures normally included in our Annual Report have been condensed or omitted as permitted by GAAP. It is important to note that the Company's results of operations and cash flows for interim periods are not necessarily indicative of the results of operations and cash flows to be expected for a full fiscal year or any interim period.

Significant Accounting Policies

A description of our significant accounting policies has been provided in Note 3 Summary of Significant Accounting Policies to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K filed for the period ended December 31, 2016.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09") that updates the principles for recognizing revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also amends the required disclosures of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for the Company beginning in its fiscal year 2018, and may be applied retrospectively to all prior periods presented or through a cumulative adjustment to the opening retained earnings balance in the year of adoption. The Company intends to adopt this standard on January 1, 2018. Due to the nature of the Company's revenue generating activites and the small number of customer contracts, the Company does not anticipate that this guidance will materially impact its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires entities to report a right-to-use asset and liability for the obligation to make payments for all leases with the exception of those leases with a term of twelve months or less. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018. The

Company intends to adopt this standard on January 1, 2019 and is currently evaluating the impact it may have on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The ASU is effective for public companies for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including interim periods within those fiscal years. An entity that elects early adoption must adopt all of the amendments in the same period. The guidance requires application using a retrospective transition method. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company’s financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The new guidance requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Entities will also be required to reconcile such total to amounts on the balance sheet and disclose the nature of the restrictions. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, and early adoption is permitted. The Company intends to adopt this standard on January 1, 2018 and is evaluating the effects, if any, that the adoption of this guidance will have on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260) Distinguishing Liabilities from Equity (Topic 480) Derivatives and Hedging (Topic 815). The new guidance intends to reduce the complexity associated with the issuer's accounting for certain financial instruments with characteristics of liabilities and equity. Specifically, the Board determined that a down round feature would no longer cause a freestanding equity-linked financial instrument (or an embedded conversion option) to be accounted for as a derivative liability at fair value with changes in fair value recognized in current earnings. In addition, the Board re-characterized the indefinite deferral of certain provisions of Topic 480 to a scope exception. The re-characterization has no accounting effect. ASU 2017-11 is effective for public entities for fiscal years beginning after December 15, 2018. The Company intends to adopt this standard on January 1, 2019 and is evaluating the effects, if any, that the adoption of this guidance will have on the Company's financial statements.

(2) Inventories

Inventories consist of the following:

(in thousands)	September 30, 2017	December 31, 2016
Raw materials	$ 328	$ 346
Work-in-process	660	214
Finished goods	176	100
Total inventories	$ 1,164	$ 660

(3) Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

(in thousands)	September 30, 2017	December 31, 2016
Insurance premiums	$ 61	$ 501
Taxes	53	—
Security Deposit	50	50
Other[1]	221	147

Total prepaid expenses and other current assets	$ 385	$ 698

[1] Other consists of various prepaid expenses and other current assets, with no individual item accounting for more than 5% of prepaid expenses and other current assets at September 30, 2017 and December 31, 2016.

(4) Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

(in thousands)	September 30, 2017	December 31, 2016
Buildings and land	$ 574	$ 556
Enterprise hardware and software	1,648	1,532
Leaseholds	1,659	1,504
Equipment	960	940
Furniture	182	354
Property, plant and equipment, gross	5,023	4,886
Accumulated depreciation	(3,770)	(3,803)
Property, plant and equipment, net	$ 1,253	$ 1,083

Depreciation expense for the three and nine months ended September 30, 2017 was approximately $0.1 million and $0.2 million, respectively, as compared to approximately $0.1 million and $0.2 million, respectively, for the same periods in 2016.

(5) Accrued Expenses

Accrued expenses consist of the following:

(in thousands)	September 30, 2017	December 31, 2016
Clinical trial expenses	1,410	1,365
Compensation, excluding taxes	$ 1,132	$ 933
Professional fees	448	286
Short-term portion of lease restructuring	221	216
Other[1]	544	607
Total accrued expenses	$ 3,755	$ 3,407

[1] Other consists of various accrued expenses, with no individual item accounting for more than 5% of current liabilities at September 30, 2017 and December 31, 2016.

(6) Restructuring Expenses

In order to help reduce operating costs and more appropriately align its office space with the reduced size of its workforce, the Company entered into two sub-leases for office space at its 810 Seventh Avenue office. On May 22, 2014, the Company entered into a sub-lease agreement ("Sub-lease #1") for approximately one-half of the office space at this location ("Suite 3500"), resulting in a lease restructuring reserve of approximately $0.9 million. On August 18, 2014, the Company entered into a sub-lease agreement ("Sub-lease #2") for the remaining one-half of office space at its 810 Seventh Avenue office ("Suite 3505"), resulting in a lease restructuring reserve of approximately $0.7 million. As of September 30, 2017, the total remaining lease restructuring liability for its leased office space was approximately $0.7 million, of which approximately $0.3 million and $0.4 million were included in Accrued expenses and Other non-current liabilities on the condensed consolidated balance sheets, respectively.

The following table provides the year-to-date activity of the Company's restructuring reserves as of September 30, 2017:

(in thousands)	Lease Liability
Reserve balance at December 31, 2016	$ 820

Charges		—
Payments/Utilizations		(155)
Reserve balance at September 30, 2017	$	665

(7) Convertible Notes Payable

On June 6, 2016, the Company entered into a Securities Purchase Agreement (the "SPA") with certain investors named on the Schedule of Buyers attached to the SPA pursuant to which the Company issued $35.0 million in principal face amount of senior secured convertible notes of the Company (the "Notes") and related Series C Warrants (the "Series C Warrants") to purchase additional shares of the Company's common stock, par value $0.01 per share ("Common Stock"). $35.0 million of the Notes were issued for cash proceeds of $32.2 million with an original issue discount in the amount of $2.8 million. The Notes are secured pursuant to a Security Agreement which creates a first priority security interest in all of the personal property (other than Excluded Collateral (as defined in the Security Agreement) of the Company of every kind and description, tangible or intangible, whether currently owned and existing or created or acquired in the future.

The Notes do not bear any ordinary interest. However, interest shall commence accruing immediately upon the occurrence of, and shall continue accruing during the continuance of, an Event of Default, at 15% per annum and shall be computed on the basis of a 360-day year of twelve 30-day months and shall be payable, if applicable, in arrears for each calendar month on the first (1st) business day of each calendar month after any such interest accrues after an Event of Default.

Under the terms of the Notes, at closing the Company received an initial tranche of $3.0 million for immediate use for general corporate purposes. A second tranche of $3.0 million was released to the Company in December 2016. An additional $6.6 million was released during the three months ended March 31, 2017. Under the terms of warrant repurchase agreements signed in April 2017 and discussed in more detail below, $7.9 million was returned to the holders in exchange for the extinguishment of the Series C Warrants. During the three months ended September 30, 2017, an additional $2.1 million was released to the Company and $2.4 million was returned to the holders in order to redeem the Series A and Series B Preferred Shares discussed in more detail in Note 8. The remaining cash proceeds of $7.3 million are being held in restricted accounts.

In connection with the issuance of the Notes under the SPA, the Company also issued Series C Warrants, exercisable to acquire appoximately 20,000 shares of Common Stock. The provisions in the Series C Warrants required the Company to account for the warrants as derivative liabilities. The Company recognized a discount to debt of $27.8 million related to the initial fair value of the Series C Warrants. On April 2, 2017 the Company entered into separate warrant repurchase agreements (the “Warrant Repurchase Agreements”) with each of the investors named on the Schedule of Buyers attached to the SPA. Pursuant to the Warrant Repurchase Agreements, each investor agreed to a Controlled Account Release, in an aggregate amount equal to $7.9 million, which funds in each case were paid to the respective investor, in exchange for cancellation of the Warrants issued to each investor under the SPA. As a result of the extinguishment, the Company recognized a gain of $9.6 million, representing the difference between the fair value of the liability as of the extinguishment date of $17.5 million related to the Series C Warrants and the $7.9 million in cash returned to the Note holders to extinguish the liability.

The Company has agreed to make amortization payments with respect to the Notes in fourteen (14) equal installments beginning seven (7) months after the original date of issuance of June 13, 2016 (each, an “Installment Date”). On each installment date, assuming certain equity conditions are met, the installment payment shall, at the election of the Company, automatically be converted into shares of Common Stock at a conversion rate defined in the agreement. If we cannot meet the equity conditions, we could be required to repay some or all of the amounts due under the notes in cash, and we may not have the funds available to make one or more of such payments when due. At any time after the issuance of the Notes, the Notes will be convertible at the election of the holder into shares of our Common Stock at a conversion price equal to $1,536.50, subject to adjustment as provided in the Notes.

Restructuring Agreement

On August 28, 2017, the Company entered into a Restructuring Agreement (the “Agreement”) with one of the institutional investors (the “Investor”) who was a party to the SPA. As of the date the Agreement was entered into, the Investor held $11,444,637 aggregate principal amount of Notes of which there was $10,092,857 aggregate Restricted Principal, (as defined in the Notes) of Notes (the “Restricted Notes”), secured by such aggregate cash amount held in a collateral account of the Company in the same amount (the “Restricted Cash”) and (y) $1,351,780 principal of Notes (the “Unrestricted Notes”), (ii) 4,200 shares of Series A Preferred Stock and (iii) 2,006 shares of Series B Convertible Preferred Stock.

Pursuant to the Agreement, (a) on the date thereof the Company and the Investor took the following actions (the “Initial Restructuring”): (i) the Investor released restrictions on $1,650,000 of Restricted Cash (the “Initial Release”), (ii) the Investor consented to the use of additional Restricted Cash to effect redemptions of the Series A Preferred Shares and the Series B Preferred Shares, (iii) the Investor cancelled $1,200,000 aggregate principal of the Notes (such portion of the Notes, the “Cancellation Note”), (iv) the Company redeemed all the Series A Preferred Shares outstanding for a cash payment to the Investor of $4.20 and (v) the Company redeemed the Series B Preferred Shares for a cash payment to the Investor of $2,006,000 and (b) upon the consummation of a reverse stock split of our Common Stock of at least twenty to one (the “Reverse Stock Split Event”, and such date, the “Reverse Stock Split Date”) by September 15, 2017, the Company and the Investor shall have taken the following actions (the “Additional Restructuring”, and together with the

Initial Restructuring, the “Restructuring”): (i) the Investor shall consent to the use of Restricted Cash to effect redemptions of $4,000,000 aggregate Restricted Principal of the Restricted Notes (such portion of the Restricted Notes, the “Redemption Notes”), (ii) the Company shall redeem the Redemption Notes for a redemption price of $6,436,852.80 (the “Redemption Price”) and (iii) the Company shall exchange (the “Exchange”), pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, $2,436,852.80 aggregate Restricted Principal of the Restricted Notes (such portion of the Restricted Notes, the “Exchange Notes”, and together with the Redemption Notes, the “Restructured Notes”) for new warrants to purchase 114,286 shares of its Common Stock (the “New Warrants”, as exercised, the “New Warrant Shares”). The New Warrants expire on the 42 month anniversary of the date of issuance and bear an exercise price of $122.50 per share (which shall be adjusted to the new lower purchase price per share if there is a subsequent “down round” financing). The Investor, in lieu of an exercise of the New Warrants pursuant to a cash payment of the aggregate exercise price of the number of New Warrants being exercised, may exercise the New Warrants, in whole or in part, by electing instead to receive upon such exercise two shares and one hundred and twenty-five thousandths of a share of the Company’s Common Stock for each Warrant Share exercised pursuant to this provision.. The transactions set forth herein were being made in reliance upon the exemption from registration provided by Rule 4(a)(2) of the Securities Act of 1933, as amended (the “1933

Act") and Rule 144(d)(3)(ii) of the 1933 Act. As a result of not having effected a reverse stock split by September 15, 2017, the Additional Restructuring did not occur.

Amendment to Restructuring Agreement

As a result of the lack of requisite approval by Delcath stockholders for the Company's proposed reverse stock split, the parties and the two investors in the Notes entered into an amendment to the August restructuring agreement on October 10, 2017 as follows: (i) on the date that the Company effects a reverse split of its common stock, (x) the Company will exchange, pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, an aggregate principal amount of those notes equal to $279,015 for new warrants to purchase an aggregate of 127,551 shares of Common Stock, and the Company shall redeem all the Series C Preferred Shares then outstanding for a cash payment of $590,000 and (ii) upon the initial consummation, on or prior to December 15, 2017, by the Company of the offering contemplated by the registration statement on Form S-1 that was filed with the SEC on October 11, 2017 the following shall occur: (i) pursuant to Section 3(b) of the Restricted Notes, the Company shall be deemed (as adjusted downward by the Black-Scholes value of the warrants being issued in this offering) to have automatically, and irrevocably, adjusted the conversion price of the Notes to 200% of the purchase price of a share of our common stock in the offering contemplated by the registration statement, (ii) the maturity date (as defined in the notes) shall automatically be extended to the earlier to occur of (x) the first anniversary of the date of consummation of the offering contemplated by the registration statement and (y) December 30, 2018, (iii) until the earlier of (x) this maturity date and (y) the 75th calendar day after the date of consummation of the offering contemplated by the registration statement, all installments to be made under the notes shall be deemed automatically deferred with no conversions during that 75 day period, (iv) the Company agreed to redeem any portion of the outstanding notes at any time requested by either investor thereto with $7.3 million in cash to be reduced by $0.6 million to redeem the Series C Preferred Stock remaining in the restricted accounts with respect to the 2016 convertible notes and (v) the conversion floor price on the notes is $0.05 and not subject to adjustments.

The Company has issued shares of Common Stock as payments of principal (including certain early repayments at the option of the holders) under the Notes as follows:

	Number of Shares of Common Stock	Number of Shares of Preferred Stock	Applicable Conversion Price	Reduction in Principal
January 12, 2017	11,753	—	$ 126.00	$ 1,478,318
January 26 - February 1, 2017[1]	4,857	—	$ 112.00	544,000
February 10, 2017	43,882	—	$ 70.00	3,045,817
February 23 - March 2, 2017[1]	2,571	—	$ 49.00	126,000
March 13, 2017	117,297	—	$ 38.50	4,417,830
April 10, 2017	169,061	—	$ 21.00	3,621,286
May 9, 2017	109,367	—	$ 17.50	1,913,915
June 7 / July 2, 2017 Exchange Agreement[2]	689,796	4,200	$ 6.09	4,200,000
July 7, 2017	114,286	—	$ 17.50	2,000,000
August 4, 2017	38,906	—	$ 24.50	1,015,848

August 28, 2017 Restructuring Agreement[3]	117,171	—	$ 10.50	1,200,000
Total	1,418,948			$23,563,014

[1] During the periods referenced above, the Company and the holders of the Notes agreed to a temporary reduction in the conversion price in order to encourage voluntary conversion of Notes by the holders thereof.

[2] On July 2, 2017, the Company entered into an exchange agreement with one of its investors which had purchased Notes, for $4.2 million aggregate principal amount of such Notes for 4,200 shares of Series A Preferred Stock. The Series A Preferred Stock shares were issued to address a short-term valuation issue for 689,796 common shares delivered to the Notes holders to close an installment period. Through the Series A Preferred Shares placement, the Company was able to value the open installment shares such that the amount of debt remaining under the Notes was reduced by $4.2 million. Additionally, the Company recognized a loss on debt settlement of $1.0 million related to this transcation.

[3] On August 28, 2017, the Company entered into a restructuring agreement with one of its investors which had purchased Notes. The restructuring agreement included a provision to exchange 117,171 shares for $1.2 million aggregate principal amount of such Notes. Additionally, the Company recognized a loss on debt settlement of $2.0 million related to this transaction. The restructuring agreement is discussed in more detail above.

As a result of the Notes including a feature such that the conversion price is based upon a formula which includes discounts to the market price of the common stock as well as having a lower effective conversion price considering the issuance discount and the value allocated to the Series C Warrants, the Company has recognized a beneficial conversion feature of $4.4 million. The original issue discount, the beneficial conversion feature, and the fair value of the issuance of the Series C Warrants are collectively considered the debt discount. The Company recorded a debt discount in the amount of $35.0 million which is being amortized over the life of the Notes using the effective interest method. As of September 30, 2017, $33.3 million of the debt discount has been amortized to interest expense. In addition to the debt discounts listed above, the Notes also include put options in the event of default and change in control as defined in the Notes. The value of such options was zero as the probability for such events was remote as of the issuance date and at September 30, 2017.

All debt issuance costs are accounted for as a deferred asset and will be amortized over the life of the Notes. As of September 30, 2017, the Company had incurred approximately $1.8 million in debt issuance costs and had amortized approximately $1.2 million of those costs.

The following table summarizes the convertible notes outstanding at September 30, 2017:

(in thousands)	
Convertible notes payable, principal	$11,437
Debt discounts	(1,701)
Net convertible note payable	$9,736

(8) Stockholders' Equity
Stock Issuances

Reverse Stock Split

On November 6, 2017, the Company effected a reverse stock split at which time Delcath's common stock began trading on the OTCQB on a one-for-three hundred and fifty (1:350) split-adjusted basis. All owners of record as of the open of the OTCQB market on November 6, 2017 received one issued and outstanding share of Delcath common stock in exchange for three hundred fifty issued and outstanding shares of Delcath common stock. No fractional shares were issued in connection with the reverse stock split. All fractional shares created by the one-for-three hundred fifty exchange were rounded up to the next whole share. The reverse stock split had no impact on the par value per share of Delcath common stock, which remains at $0.01. All current and prior period amounts related to shares, share prices and earnings per share, presented in the Company's interim condensed consolidated financial statements contained in the Quarterly Report on Form 10-Q and the accompanying Notes, have been restated to give retrospective presentation for the reverse stock split.]

On July 19, 2016, shareholders of the Company approved, through a shareholder vote, an amendment to the Company's Amended and Restated Certificate of Incorporation authorizing the Board of Directors to effect a reverse stock split of Delcath's common stock at a ratio within a range of one-for-ten (1:10) to one-for-twenty (1:20). The reverse stock split became effective on July 21, 2016 at which time Delcath's common stock began trading on the NASDAQ Stock Exchange on a one-for-sixteen (1:16) split-adjusted basis. All owners of record as of the open of the NASDAQ market on July 21, 2016 received one issued and outstanding share of Delcath common stock in exchange for sixteen issued and outstanding shares of Delcath common stock. No fractional shares were issued in connection with the reverse stock split. All fractional shares created by the one-for-sixteen exchange were rounded up to the next whole share. The reverse stock split had no impact on the par value per share of Delcath common stock, which remains at $0.01. All current and prior period amounts related to shares, share prices and earnings per share, presented in the Company's interim condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q and the accompanying Notes, have been restated to give retrospective presentation for the reverse stock split.

In addition, shareholders of the Company also approved an amendment to the Company's Amended and Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 170,000,000 to 500,000,000. The previously discussed reverse stock split had no impact on the increase in authorized shares.

Recent Preferred Stock Issuances

Series A Preferred Stock

On June 29, 2017, our Board authorized the establishment of a new series of preferred stock designated as Series A Preferred Stock, $0.01 par value, the terms of which are set forth in the certificate of designations for such series of Preferred Stock (the

"Series A Certificate of Designations") which was filed with the State of Delaware on June 30, 2017 (together with any preferred shares issued in replacement thereof in accordance with the terms thereof, the "Series A Preferred Stock"). On July 2, 2017, we entered into an exchange agreement (the "Exchange") with one of our investors which had purchased certain senior secured convertible notes (the "Notes"), convertible into shares of our common stock pursuant to a certain June 6, 2016 securities purchase agreement, of $4.2 million aggregate principal amount of such Notes for 4,200 shares of Series A Preferred Stock (the "Series A Preferred Shares"). The Exchange was made in reliance upon the exemption from registration provided by Rule 3(a)(9) of the Securities Act of 1933, as amended. The Series A Preferred Shares were entitled to the whole number of votes equal to $4.2 million divided by $1,288.00 (the closing bid price on June 13, 2016, the date of issuance of the Notes as adjusted for the reverse stock split effected in July 2016,) or 3,261 votes. The Series A Preferred Stock had no dividend, liquidation or other preferential rights to our common stock, and each share of Series A Preferred Stock was redeemed for the amount of $0.001, paid in cash pursuant to the Restructuring Agreement signed on August 28, 2017 and discussed in further detail in Note 7.

Series B Preferred Stock

On June 29, 2017, our Board authorized the establishment of a new series of preferred stock designated as Series B Preferred Stock, $0.01 par value, the terms of which are set forth in the certificate of designations for such series of Preferred Stock (the "Series B Certificate of Designations") which was filed with the State of Delaware on June 30, 2017 (together with any preferred shares issued in replacement thereof in accordance with the terms thereof, the "Series B Preferred Stock"). On July 11, 2017, we entered into a securities purchase agreement with existing holders of Notes pursuant to which the investors purchased $2,360,000 of Series B Preferred Stock for a cash purchase price of $2,000,000 in a private placement. The Series B Preferred Stock was entitled to the whole number of votes equal to $2.0 million divided by $65.35 (the closing bid price on July 5, 2017, the date of the original securities purchase agreement for the Series B Preferred Stock), or 30,607 votes. The Series B Preferred Stock had no dividend, liquidation or other preferential rights (but had the redemption rights described below) to our common stock and could have been converted into shares of our common stock at a price equal to $53.55 per share upon the earlier of the date of closing to the extent that the holder thereof reallocated shares of our common stock reserved for issuance under its Notes to conversion of the Series B Preferred Shares and otherwise upon receipt of shareholder approval of the Reverse Stock Split. The Series B Preferred Stock allowed for optional redemption by the Company at any time after issuance or the holders at any time after the tenth business day prior to the maturity date. In the instance of a Financing, the Company was required to redeem the Series B Preferred Stock. The $360,000 difference between the redemption amount and the cash purchase price of the Series B Preferred Stock, as well as all issuance costs related to the Series B Preferred Stock, have been recorded as a deemed dividend. The Series B Preferred Stock was redeemed for $2,360,000 pursuant to the Restructuring Agreement signed on August 28, 2017 with one investor and upon a redemption notice from the second investor as discussed in further detail in Note 7.

Series C Preferred Stock

On September 12, 2017, our Board authorized the establishment of a new series of preferred stock designated as Series C Preferred Stock, $0.01 par value, the terms of which are set forth in the certificate of designations for such series of Preferred Stock which was filed with the State of Delaware on September 20, 2017. On September 21, 2017, we entered into a securities purchase agreement with two of our investors which had purchased Notes, convertible into shares of our common stock pursuant to a certain June 6, 2016 securities purchase agreement, of $0.5 million aggregate purchase price for 590 shares of Series C Preferred Stock. The purchase of the Series C Preferred Stock is being made in reliance upon the exemption from registration provided by Rule 4(a)(2) of the Securities Act of 1933, as amended. The Series C Preferred Stock shall be entitled to 1,484,061 votes and may only vote on approval of a reverse split of our outstanding common stock. The Series C Preferred Stock has no dividend, liquidation or other preferential rights to our common stock, and each share of Series C Preferred Stock shall be redeemable for the amount of $1,000.00, payable in cash per share at our written election, and must be redeemed by us no later than December 21, 2017. Because the Series C Preferred Stock is mandatorily redeemable, it has been recorded as a liability with the difference between the purchases price and the fair value being recognized over the term of the instrument. Additionally, all expenses related to the issuance of the Series C Preferred Stock are recognized as a debt discount and have been amortized over the term of the instrument. Per the terms of the October 22, 2017 Amendment to the Restructuring Agreement, the Series C Preferred Stock was redeemed for $590,000 on November 6, 2017.

Warrants

In October 2013, the Company completed the sale of 234 shares of its common stock and the issuance of warrants to purchase approximately 106 common shares (the “2013 Warrants”) pursuant to a placement agency agreement. The Company received proceeds of $7.5 million, with net cash proceeds after related expenses from this transaction of approximately $6.9 million. Of those proceeds, the Company allocated an estimated fair value of $1.9 million to the 2013 Warrants. The exercise price is subject to appropriate adjustment in the event of stock dividends, stock splits, reorganizations or similar events affecting our common stock. At September 30, 2017, the 2013 Warrants were exercisable at $39,424.00 per share with approximately 100 warrants outstanding. The 2013 Warrants have a five-year term.

In February 2015, the Company completed the sale of approximately 440 shares of its common stock and the issuance of warrants to purchase 197 common shares (the "February 2015 Warrants") pursuant to an underwriting agreement. The Company received proceeds of $2.6 million, with net cash proceeds after related expenses from this transaction of $2.5 million. Of those proceeds, the Company allocated an estimated fair value of $0.8 million to the February 2015 Warrants. The exercise price is subject to appropriate adjustment in the event of stock dividends, stock splits, reorganizations or similar events affecting our common stock. The exercise price of the warrants is also subject to anti-dilution adjustments for any issuance of common stock or rights to acquire common stock for consideration per share less than the exercise price of the warrants. At September 30, 2017, the February 2015 Warrants were exercisable at $49.00 per share with approximately 100 warrants outstanding. The February 2015 Warrants have a five-year term.

In July 2015, the Company completed the sale of approximately 1,715 Units consisting of approximately 1,715 shares of its common stock, Series A Warrants to purchase up to approximately 1,140 common shares ("Series A Warrants") and Series B Warrants to purchase Units consisting of up to approximately 1,715 common shares ("Series B Warrants") and 1,140 Series A Warrants pursuant to an underwriting agreement. The Company received proceeds of $7.0 million, with net cash proceeds after related expenses from this transaction of $6.0 million. Of those proceeds the Company allocated an estimated fair value of $3.4 million to the Series A and Series B Warrants. During the three months ended March 31, 2016, approximately 285 Series B Warrants were exercised for net proceeds of approximately $0.8 million. The remaining 1,140 Series B Warrants expired on January 29, 2016 and the remaining liability was credited to Change in the fair value of the warrant liability. As a result of the Series B Warrant exercises, an additional 285 Series A Warrants were issued. The exercise price of the Series A Warrants is subject to appropriate adjustment in the event of stock dividends, stock splits, reorganizations or similar events affecting our common stock and is subject to anti-dilution adjustments for any issuance of common stock or rights to acquire common stock for consideration per share less than the exercise price of the warrants. At September 30, 2017, the Series A Warrants were exercisable at $49.00 with approximately 500 warrants outstanding. The Series A Warrants have a five-year term. There were approximately 285 July 2015 Series A Warrants exercised during the nine months ended September 30, 2017 for proceeds of approximately $15,000.

In October 2016, the Company completed the sale of approximately 1,215 shares of its common stock and the issuance of warrants to purchase 425 common shares (the "October 2016 Warrants") pursuant to an underwriting agreement. The Company received proceeds of $1.2 million, with net cash proceeds after related expenses from this transaction of $1.1 million. Of those proceeds, the Company allocated an estimated fair value of $0.3 million to the October 2016 Warrants. The exercise price is subject to appropriate adjustment in the event of stock dividends, stock splits, reorganizations or similar events affecting our common stock. The exercise price of the warrants is also subject to anti-dilution adjustments for any issuance of common stock or rights to acquire common stock for consideration per share less than the exercise price of the warrants. For purposes of these adjustments, dilutive issuances do not include securities issued under existing instruments, under board-approved equity incentive plans or in certain strategic transactions. At September 30, 2017, the October 2016 Warrants were exercisable at $49.00 per share with 200 warrants outstanding. The October 2016 Warrants have a five-year term.

Stock Incentive Plans

The Company established the 2004 Stock Incentive Plan and the 2009 Stock Incentive Plan (collectively, the "Plans") under which 34 and 573 shares, respectively, have been reserved for the issuance of stock options, stock appreciation rights, restricted stock, stock grants and other equity awards. In July 2016, the total number of shares of Delcath common stock reserved for issuance under the 2009 Stock Incentive Plan was increased by 304 shares, from 269 to 573 shares, upon a favorable vote by the Company’s stockholders. The Plans are administered by the Compensation and Stock Option Committee of the Board of Directors which determines the individuals to whom awards shall be granted as well as the type, terms, conditions, option price and the duration of each award. As of September 30, 2017 there were 55 shares available to grant under the 2009 Stock Incentive Plan.

A stock option grant allows the holder of the option to purchase a share of the Company’s common stock in the future at a stated price. Options and Restricted Stock granted under the Plans vest as determined by the Company’s Compensation and Stock Option Committee. Options granted under the Plans expire over varying terms, but not more than ten years from the date of grant.

For the three and nine months ended September 30, 2017, the Company recognized compensation expense of approximately $3,000 and $48,000, respectively, relating to stock options granted to employees. For the same periods in 2016, the Company recognized compensation expense of approximately $24,000 and $0.1 million, respectively. There were 43 stock options awards granted during the nine months ended September 30, 2017. There were no stock option awards granted during the same period in 2016.

For the three and nine months ended September 30, 2017, the Company recognized compensation expense of approximately $20,000 and $0.1 million, respectively, relating to restricted stock granted to employees. For the same periods in 2016, the Company recognized compensation expense of approximately $38,000 and $0.2 million, respectively. There were 264 shares of restricted stock granted during the nine months ended September 30, 2017. There were approximately no shares of restricted stock awards granted for the same period in 2016.

(9) Fair Value Measurements
Derivative Warrant Liability

As disclosed in Note 8 of the Company's interim condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q, the Company allocated part of the proceeds of public offerings in 2013, 2015 and 2016 of the Company's common stock to warrants issued in connection with those transactions. In addition, the Company recognized a discount to debt related to the initial fair value of warrants issued in connection with the June 2016 Convertible Notes discussed in further detail in Note 7 of the Company's interim condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q. The valuation of the October 2013, February 2015, July 2015 Series A, June 2016 Series C and October 2016 warrants (collectively, the "Warrants") were determined using option pricing models. These models use inputs such as the underlying price of the shares issued at the measurement date, volatility, risk free interest rate and expected life of the instrument. The Company has classified the Warrants as a current liability due to certain provisions relating to price adjustments and potential cash payments, as well as the holders' ability to exercise the warrants within twelve months of the reporting date and has accounted for them as derivative instruments in accordance with ASC 815, adjusting the fair value at the end of each reporting period. Additionally, the Company has determined that the warrant derivative liability should be classified within Level 3 of the fair-value hierarchy by evaluating each input for the option pricing models against the fair-value hierarchy criteria and using the lowest level of input as the basis for the fair-value classification as called for in ASC 820. There are six inputs: closing price of Delcath stock on the day of evaluation; the exercise price of the warrants; the remaining term of the warrants; the volatility of Delcath's stock over that term; annual rate of dividends; and the risk-free rate of return. Of those inputs, the exercise price of the warrants and the remaining term are readily observable in the warrant agreements. The annual rate of dividends is based on the Company's historical practice of not granting dividends. The closing price of Delcath stock would fall under Level 1 of the fair-value hierarchy as it is a quoted price in an active market (ASC 820-10). The risk-free rate of return is a Level 2 input as defined in ASC 820-10, while the historical volatility is a Level 3 input as defined in ASC 820. Since the lowest level input is a Level 3, Delcath determined the warrant derivative liability is most appropriately classified within Level 3 of the fair value hierarchy.

For the three and nine months ended September 30, 2017, the Company recorded pre-tax derivative warrant income of approximately $27,000 and $1.2 million, respectively. The resulting derivative warrant liabilities totaled approximately $16,000 at September 30, 2017. Management expects that the Warrants will either be exercised or expire worthless. The fair value of the Warrants at September 30, 2017 was determined by using option pricing models with the following assumptions:

	October 2016 Warrants	July 2015 Series A Warrants	February 2015 Warrants	October 2013 Warrants
Expected volatility	142.46%	165.32%	181.24%	227.68%
Risk-free interest rates	1.77%	1.59%	1.53%	1.33%
Expected life (in years)	4.02	2.81	2.38	1.08

The table below presents the Company’s assets and liabilities measured at fair value on a recurring basis as of September 30, 2017, aggregated by the level in the fair value hierarchy within which those measurements fall in accordance with ASC 820.

	Assets and Liabilities Measured at Fair Value on a Recurring Basis			
(in thousands)	Level 1	Level 2	Level 3	Balance at September 30, 2017
Liabilities				
Derivative instrument liabilities	$—	$ —	$ 16	$ 16

For the periods ended September 30, 2017 and 2016, there were no transfers in or out of Level 1, 2 or 3 inputs.