



Boston, United States
Sydney, Australia
28 February 2020 AEDT

Appendix 4E: Preliminary Final Report Year Ended 31 December 2019

BOSTON and SYDNEY — 28 February 2020 — GI Dynamics® Inc. (ASX:GID), a medical device company that is developing EndoBarrier® for patients with type 2 diabetes and obesity, today released its preliminary financial results for the year ended 31 December 2019 (“Results”). The Appendix 4E, which has been prepared in U.S. Dollars and in accordance with U.S. GAAP, is attached. The Results disclosed in the Appendix 4E are unaudited. The Results are currently being audited by the Company’s auditors, Wolf & Company, P.C., with final audited results to be filed as part of the Annual Report on Form 10-K with the U.S. Securities and Exchange Commission and the Australian Securities Exchange on or before 30 March 2020.

Summary of Results

- The Company did not record any revenue for the years 31 December 2019 and 31 December 2018.
- Loss from operations was US\$9.3 million for the year ended 31 December 2019 compared to US\$7.6 million for the year ended 31 December 2018.
- Loss from ordinary activities after tax was US\$17.3 million for the year ended 31 December 2019 compared to US\$8.0 million for the year ended 31 December 2018.
- The Company had cash and cash equivalents of US\$2.5 million at 31 December 2019 compared to US\$3.8 million at 31 December 2018.

**Chief Financial Officer /
Secretary**
United States:
Charles Carter
+1 (781) 357-3263
ccarter@gidynamics.com

Please refer to the attached Appendix 4E, including the unaudited consolidated financial statements, for additional explanation and details.

Investor Relations
United States:
Janell Shields
+1 (781) 357-3280
investor@gidynamics.com

This announcement has been authorized for release by Charles Carter, Chief Financial Officer and Company Secretary of GI Dynamics.



Boston, United States
Sydney, Australia
28 February 2020 AEDT

About GI Dynamics

GI Dynamics®, Inc. (ASX:GID) is the developer of EndoBarrier®, the first endoscopically-delivered medical device for the treatment of type 2 diabetes and obesity. EndoBarrier is not approved for sale and is limited by federal law to investigational use only. EndoBarrier is subject to an Investigational Device Exemption by the FDA in the United States and is entering concurrent pivotal trials in the United States and India. Founded in 2003, GI Dynamics is headquartered in Boston, Massachusetts. For more information please visit.

Forward-Looking Statements

This announcement may contain forward-looking statements. These statements are based on GI Dynamics management's current estimates and expectations of future events as of the date of this announcement. Furthermore, the estimates are subject to several risks and uncertainties that could cause actual results to differ materially and adversely from those indicated in or implied by such forward-looking statements.

These risks and uncertainties include, but are not limited to, risks associated with our ability to continue to operate as a going concern; our ability to obtain stockholder approval of the conversion feature of the August 2019 Note and issuance of the August 2019 Warrant, our ability to raise sufficient additional funds to continue operations and to conduct the planned pivotal trial of EndoBarrier in the United States (STEP-1); our ability to execute STEP-1 under FDA's Investigational Device Exemption; our ability to enlist clinical trial sites and enroll patients in accordance with STEP-1; the risk that the FDA stops STEP-1 early as a result of the occurrence of certain safety events or does not approve an expansion of STEP-1; our ability to enroll patients in accordance with I-STEP; our ability to secure a CE Mark; our ability to maintain compliance with our obligations under our existing convertible note and warrant agreements executed with Crystal Amber, including our obligations to make payment on the Note that is due on 31 March 2020 and our ability to restructure the

Chief Financial Officer / Secretary

United States:
Charles Carter
+1 (781) 357-3263
ccarter@gidynamics.com

Investor Relations

United States:
Janell Shields
+1 (781) 357-3280
investor@gidynamics.com



Boston, United States
Sydney, Australia
28 February 2020 AEDT

terms of the Note with Crystal Amber that is due on 31 March 2020 if we are unable to raise sufficient funds to enable us to fully repay such Note when due; obtaining and maintaining regulatory approvals required to market and sell our products; the possibility that future clinical trials will not be successful or confirm earlier results; the timing and costs of clinical trials; the timing of regulatory submissions; the timing, receipt and maintenance of regulatory approvals; the timing and amount of other expenses; the timing and extent of third-party reimbursement; intellectual-property risk; risks related to excess inventory; risks related to assumptions regarding the size of the available market; the benefits of our products; product pricing; timing of product launches; future financial results; and other factors, including those described in our filings with the U.S. Securities and Exchange Commission.

Given these uncertainties, one should not place undue reliance on these forward-looking statements. We do not assume any obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events or otherwise, unless we are required to do so by law.

###

**Chief Financial Officer /
Secretary**

United States:
Charles Carter
+1 (781) 357-3263
ccarter@gidynamics.com

Investor Relations

United States:
Janell Shields
+1 (781) 357-3280
investor@gidynamics.com

Appendix 4E

Preliminary Final Report

1. Company Information

GI Dynamics, Inc.

ABN

151 239 388

Year ended ("current year")

31 December 2019

The previous corresponding period refers to the comparative amounts for the year ended 31 December 2018.

All values contained in this report are stated in U.S. dollars and have been rounded to the nearest thousand, unless otherwise stated.

2. Results for Announcement to the Market

Year Ended 31 December 2019 Compared to Year Ended 31 December 2018

	Current Year 12 Months Ended 31 December 2019 \$'000 USD	Prior Year 12 Months Ended 31 December 2018 \$'000 USD	Amount of Increase or (Decrease) \$'000 USD	Percentage Increase or (Decrease)
2.1 Revenue from ordinary activities	0	0	0	0%
Loss from operations	(9,314)	(7,622)	1,692	22%
2.2 Loss from ordinary activities, after tax	(17,299)	(8,038)	9,261	115%
2.3 Loss attributable to members	(17,299)	(8,038)	9,261	115%

The Company does not propose to pay dividends to common stock or CDI holders at this time. As such, there is no franking or applicable record date.

GI Dynamics, Inc. (the "Company") was incorporated on 24 March 2003, as a Delaware corporation, with operations based in Boston, Massachusetts. The Company is a clinical stage medical device company focused on the development and commercialization of EndoBarrier, a medical device system intended for treatment of patients with type 2 diabetes and obesity. EndoBarrier is a medical implant designated for the treatment of type 2 diabetes and obesity with nearly 4,000 implants since

Appendix 4E

Preliminary Final Report

inception and is the subject of an approved FDA pivotal trial in the United States under which the Company has initiated patient implant procedures. The Company believes that EndoBarrier represents a paradigm-breaking approach to traditional management of type 2 diabetes, which has focused historically solely on lifestyle intervention and diabetes medications.

To date, the Company has devoted substantially all of its efforts to research and development, business planning, clinical research, clinical study management, reimbursement development, product commercialization, acquiring operating assets and raising capital.

In 2011, the Company began commercial sales of its product, EndoBarrier, which was approved and commercially available in multiple countries outside the U.S. at the time.

In the U.S., the Company received approval from the Food and Drug Administration (“FDA”) to commence its pivotal trial of EndoBarrier (the “ENDO Trial”), which the Company began in 2013 and ended in the second half of 2015. The Company announced on August 21, 2015 that as a result of stopping the ENDO trial, it was reducing headcount by approximately 46% as part of its efforts to restructure its business and expenses and to ensure sufficient cash remained available for it to establish new priorities, continue limited market development and research and evaluate strategic options.

In the second and third quarters of fiscal 2016, the Company took additional actions that it thought necessary to evolve its strategic options. These actions resulted in non-recurring charges totaling approximately \$1.1 million, including \$400 thousand related to restructuring charges in our second quarter, \$600 thousand related to employee departures in both our second and third quarters and \$100 thousand related to abandonment of our former headquarters in Lexington, MA.

In October 2016, the Company received final cancellation notification from the Therapeutic Goods Administration (“TGA”) for the listing of EndoBarrier on the Australian Register of Therapeutic Goods (“ARTG”).

In May 2017, the Company received notification from its notified body, SGS United Kingdom Limited (“SGS”), that the CE Mark for EndoBarrier had been suspended pending closure of non-conformances related to its quality management system required under International Organization for Standardization (“ISO”) regulations.

On November 10, 2017, the Company received notification from SGS that SGS was withdrawing the Certificate of Conformance for EndoBarrier, ending the CE Marking of EndoBarrier in Europe and select Middle East countries.

In December 2017, the Company received notification from the Medicines and Healthcare Products Regulatory Agency (“MHRA”) that all EndoBarrier delivery systems (liners) in customers’ inventory need to be returned to the Company.

In August 2018, the Company received approval of an IDE from the FDA to begin enrollment in a pivotal trial evaluating the safety and efficacy of EndoBarrier in the United States pending IRB approval, which was received in February 2019.

The Company did not record any revenue for the years ended 31 December 2019 and 31 December 2018.

The Company’s loss from operations increased by \$1.7 million for the twelve months ended 31 December 2019 as compared with 2018 and was primarily due to increases in research and development efforts related to the STEP-1 trial in the United States and the I-Step trial in India.

The increase in research and development expenses was primarily a result of increased spend due to preparation for the STEP-1 and I-Step trials.

The decrease in sales and marketing expenses was primarily the result of a decrease in overall sales and marketing activities and a reclassification of existing overseas employee efforts to research and

development.

The increase in general and administrative expenses was primarily due to increases in insurance costs, increased support costs for higher headcount and additional legal and insurance costs related to transacting multiple financing events as a public company subject to reporting in two jurisdictions.

The Company's after-tax loss from ordinary activities and loss attributable to members was approximately \$17.3 million for the year ended 31 December 2019 as compared to approximately \$8 million for the year ended 31 December 2018, a decrease in loss of approximately \$9.3 million, or 115%, and was a result of the reasons described above.

At 31 December 2019 the Company had cash and cash equivalents of approximately \$2.5 million compared to approximately \$3.8 million at 31 December 2018, a decrease of approximately \$1.3 million. The decrease is primarily attributable to net cash used in operating activities of \$10.6 million offset by net cash provided by financing activities of \$9.3 million.

3. Statement of Financial Performance

Please see the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto.

4. Statement of Financial Position

Please see the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto.

5. Statement of Cash Flows

Please see the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto.

6. Dividends per Security

The Company did not declare or pay any dividends on common stock (or CDIs) and does not propose to pay any such dividends at this time.

7. Dividend or Distribution Reinvestment Plans

Not applicable; the Company has no dividend or distribution reinvestment plans.

8. Statement of Retained Earnings

Please see the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto.

9. Net Tangible Assets per Security

	Current Year 31 December 2019	Prior Year 31 December 2018
Net tangible assets (in \$'000 USD)	-3,006	-3,445
Issued equity (common stock and APIC) (in \$'000 USD)	281,452	263,714
Number of shares of common stock on issue at reporting date	36,598,291	19,277,545
Net tangible assets per security (common share)	(\$0.08) (\$0.01 per CDI)	(\$0.18) (\$0.01 per CDI)

10. Acquisitions and Divestments

Not applicable; no entities were acquired or disposed of during 2019.

11. Joint Ventures

Not applicable; the Company is not and has not been a party to any joint ventures.

12. Other Information

Please see the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto. Please also see the Company's other documents on file with the ASX.

13. Foreign Entity Accounting Standards

The Company's financial statements are presented in accordance with accounting principles generally accepted in the United States and are denominated in U.S. dollars.

14. Commentary on Results for 2019

Please see Section 2 above and the Company's unaudited consolidated financial statements, with accompanying notes, which are attached hereto. The Company operated in one segment only in 2019.

15. Status of Audit or Review

The financial statements, including accompanying notes, attached hereto are in the process of being audited. Such audit will be finalized and the audited consolidated financial statements as of and for the 12 months ended 31 December 2019 will be filed as part of the Annual Report on Form 10-K with the U.S. Securities and Exchange Commission and the ASX on or before 30 March 2020.

16. Audit Report (Unaudited Financials)

An audit of the Company's financial statements is currently in process. The Company anticipates that its audited financial statements will contain an independent audit report which includes a paragraph stating that because it has incurred operating losses and negative cash flows from operations since inception and will be required to obtain additional financing, alternative means of financial support or both in order to continue to fund the Company's operations, there is substantial doubt about its ability to continue as a going concern.

17. Audit Report (Audited Financials)

Not applicable; an audit of the Company's financial statements is still in process.

GI Dynamics, Inc. and Subsidiaries
Consolidated Balance Sheets
(In thousands, except share and per share amounts)

	December 31,	
	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,499	\$ 3,806
Restricted cash	30	30
Prepaid expenses and other current assets	1,247	530
Total current assets	3,776	4,366
Property and equipment, net	42	63
Right-of-use assets, net of amortization	415	—
Total assets	\$ 4,233	\$ 4,429
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable	\$ 636	\$ 1,050
Accrued expenses	1,292	1,645
Short term debt to related party, net of debt discount	4,886	4,960
Derivative liabilities	10	51
Short term lease liabilities	181	—
Total current liabilities	7,005	7,706
Long term debt to related party, net of discount	—	168
Long term lease liabilities	234	—
Total liabilities	7,239	7,874
Commitments (Note 11)		
Stockholders' deficit:		
Preferred stock, \$0.01 par value – 500,000 shares authorized; no shares issued and outstanding at December 31, 2019 and 2018	—	—
Common stock, \$0.01 par value – 75,000,000 and 50,000,000 shares authorized at December 31, 2019 and December 31, 2018, respectively; 36,598,291 and 19,277,545 shares issued and outstanding at December 31, 2019 and 2018, respectively	2,337	193
Class B common stock, \$0.01 par value – zero shares authorized at December 31, 2019 and December 31, 2018; no shares issued and outstanding at December 31, 2019 and 2018	—	—
Additional paid-in capital	279,115	263,521
Accumulated deficit	(284,458)	(267,159)
Total stockholders' deficit	(3,006)	(3,445)
Total liabilities and stockholders' deficit	\$ 4,233	\$ 4,429

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

GI Dynamics, Inc. and Subsidiaries
Consolidated Statements of Operations
(In thousands, except share and per share amounts)

	Years Ended December 31,	
	2019	2018
Revenue	\$ —	\$ —
Cost of revenue	—	—
Gross loss	—	—
Operating expenses:		
Research and development	4,137	1,947
Sales and marketing	22	866
General and administrative	5,155	4,809
Total operating expenses	9,314	7,622
Loss from operations	(9,314)	(7,622)
Other income (expense):		
Interest income	3	29
Interest expense	(6,377)	(1,151)
Foreign exchange loss	11	13
Income (expense) from diverted funds and insurance claim	—	224
Re-measurement of derivative liabilities	(1,683)	482
Gain on write-off of accounts payable	101	—
Other income (expense), net	(7,945)	(403)
Loss before income tax expense	(17,259)	(8,025)
Income tax expense	40	13
Net loss	\$ (17,299)	\$ (8,038)
Basic and diluted net loss per common share	(0.47)	(0.59)
Weighted-average number of common shares used in basic and diluted net loss per common share	36,598,291	13,699,585

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

GI Dynamics, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Deficit
(In thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Par Value			
Balance at December 31, 2017	11,157,489	112	255,294	(259,121)	(3,715)
Issuance of shares upon private placement, net of issuance costs	8,120,056	81	6,353	—	6,434
Beneficial conversion feature discounts associated with 2018 Note	—	—	1,007	—	1,007
Relative fair value of warrant issued with 2018 Note	—	—	743	—	743
Stock-based compensation expense	—	—	124	—	124
Net loss	—	—	—	(8,038)	(8,038)
Balance at December 31, 2018	19,277,545	193	263,521	(267,159)	(3,445)
Reclassification of derivative liabilities to additional paid-in capital upon stockholder approval	—	—	5,784	—	5,784
Issuance of common shares upon conversion of notes payable to related party	9,072,197	91	5,900	—	5,991
Exercise of related party warrants	8,248,549	2,053	3,349	—	5,402
2017 Note modification	—	—	328	—	328
Stock-based compensation expense	—	—	233	—	233
Net loss	—	—	—	(17,299)	(17,299)
Balance at December 31, 2019	36,598,291	2,337	279,115	(284,458)	(3,006)

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

GI Dynamics, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)

	Years Ended December 31,	
	2019	2018
Operating activities:		
Net loss	\$ (17,299)	\$ (8,038)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	32	35
Loss on disposal of leasehold improvements	—	2
Stock-based compensation expense	233	124
Non-cash interest expense	6,372	683
Re-measurement of derivative liabilities	1,683	(18)
Changes in operating assets and liabilities:		
Accounts receivable	—	40
Prepaid expenses and other current assets	(717)	(265)
Accounts payable	(414)	(141)
Accrued expenses	(502)	265
Deferred revenue	—	(11)
Net cash used in operating activities	(10,612)	(7,324)
Investing activities		
Purchases of property and equipment	(11)	(3)
Net cash used in investing activities	(11)	(3)
Financing activities		
Proceeds from issuance of common stock, net of issuance costs	—	6,434
Debt issuance costs	(87)	(85)
Proceeds from exercise of related party warrants	5,403	—
Proceeds from short term and long term debt, related party	4,000	1,750
Net cash provided by financing activities	9,316	8,099
Net decrease in cash and cash equivalents	(1,307)	772
Cash and cash equivalents at beginning of year	3,836	3,064
Cash and cash equivalents at end of year	\$ 2,529	\$ 3,836
Supplemental cash flow disclosures		
Income taxes paid	40	12
Beneficial conversion feature discount associated with 2018 Note	—	1,007
Relative fair value of warrant issued with 2018 Note	—	743
Beneficial conversion feature discount associated with 2017 Note modification	—	40
Interest paid	394	—
Modification of 2017 Note	328	—
Exercise of related party warrants in exchange for subscription receivable from related party	2,000	—
Right-of-use asset obtained in exchange for lease liability	509	—
Conversion of notes payable to related party into common stock	5,991	—
Reclassification of warrant from derivative liabilities to additional paid-in capital	5,784	—
Fair value of warrants issued with Notes to Related Party	4,072	—

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

GI Dynamics, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

1. Nature of Business

GI Dynamics® is a clinical stage medical device company focused on the development and commercialization of EndoBarrier, a medical device intended to treat patients with type 2 diabetes and to reduce obesity.

Diabetes mellitus type 2 (also known as type 2 diabetes) is a long-term progressive metabolic disorder characterized by high blood sugar, insulin resistance, and reduced insulin production. People with type 2 diabetes represent 90-95% of the worldwide diabetes population; only 5-10% of this population is diagnosed with type 1 diabetes (a form of diabetes mellitus wherein little to no insulin is produced).

Being overweight is a condition where the patient's BMI is greater than 25 (kg/m²); obesity is a condition where the patient's BMI is greater than 30. Obesity and its comorbidities contribute to the progression of type 2 diabetes. Many experts believe obesity contributes to higher levels of insulin resistance, which creates a feedback loop that increases the severity of type 2 diabetes.

When considering treatment for type 2 diabetes, it is optimal to address obesity concurrently with diabetes.

EndoBarrier® is intended for the treatment of type 2 diabetes and to reduce obesity in a minimally invasive and reversible manner.

The current treatment paradigm for type 2 diabetes is lifestyle therapy combined with pharmacological treatment, whereby treating clinicians prescribe a treatment regimen of one to four concurrent medications that could include insulin for patients with higher levels of blood sugar. Insulin carries a significant risk of increased mortality and may contribute to weight gain, which in turn may lead to higher levels of insulin resistance and increased levels of blood sugar. Fewer than 50% of patients treated pharmacologically for type 2 diabetes are adequately managed, meaning that medication does not lower blood sugar adequately and does not halt the progressive nature of diabetes of these patients.

The current pharmacological treatment algorithms for type 2 diabetes fall short of ideal, creating a large and unfilled efficacy gap.

The GI Dynamics vision is to make EndoBarrier the essential nonpharmacological and non-anatomy-altering treatment for patients with type 2 diabetes. The Company intends to achieve this vision by providing a safe and effective device, focusing on optimal patient care, supporting treating clinicians, adding to the extensive body of clinical evidence around EndoBarrier, gaining appropriate regulatory approvals, continuing to improve its products and systems, operating the Company in a lean fashion, and maximizing stockholder value.

EndoBarrier® is intended for the treatment of type 2 diabetes and to reduce obesity in a minimally invasive and reversible manner and is designed to mimic the mechanism of action of duodenal-jejunal exclusion created by gastric bypass surgery.

Since incorporation, the Company has devoted substantially all of its efforts to product commercialization, research and development, business planning, recruiting management and technical staff, acquiring operating assets, and raising capital. The Company currently operates in one reportable business segment.

EndoBarrier History

In 2011, GI Dynamics began commercial sales of its product, EndoBarrier, which was approved and commercially available in multiple countries outside the U.S. at the time.

In the U.S., GI Dynamics received approval from the FDA to commence the ENDO trial, which the Company began in 2013 and ended in the second half of 2015 with an announcement of the decision to stop the ENDO trial. In the second half of 2015, the Company announced that as a result of stopping the ENDO trial, it was reducing headcount by approximately 46% as part of its efforts to restructure its business and expenses and to ensure sufficient cash remained available for it to establish new priorities, continue limited market development and research, and to evaluate its strategic

options. Subsequently, additional actions were taken that management thought necessary to evolve the Company's strategic options.

In October 2016, GI Dynamics received final cancellation notification from the TGA for the listing of EndoBarrier on the ARTG.

In May 2017, GI Dynamics received notification from its notified body, SGS, that the CE Mark for EndoBarrier had been suspended pending closure of non-conformances related to its quality management system required under ISO regulations.

On November 10, 2017, GI Dynamics received notification from SGS that SGS was withdrawing the Certificate of Conformance for EndoBarrier, ending the CE Marking of EndoBarrier in Europe and select Middle East countries.

In December 2017, GI Dynamics received notification from the MHRA that all EndoBarrier delivery systems (liners) in inventory needed to be returned to the Company.

In August 2018, GI Dynamics received approval of an IDE from the FDA to begin enrollment in a pivotal trial evaluating the safety and efficacy of EndoBarrier in the United States pending IRB, which was received in February 2019. This U.S. clinical trial is referred to as the GI Dynamics STEP-1 clinical trial and qualifies as the registration trial for EndoBarrier in the United States.

In January 2020, the first patient was randomized into the GI Dynamics STEP-1 clinical trial.

GI Dynamics Financing History

From its inception in 2003 to its IPO in 2011, GI Dynamics was financed by a series of preferred stock financings. In September 2011, GI Dynamics completed its IPO of common stock in the form of CDI, each representing 1/50th of a share of common stock, in Australia. As a result of the IPO and simultaneous private placement in the U.S., GI Dynamics raised a total of approximately \$72.5 million in proceeds, net of expenses and the concurrent repayment of \$6 million in outstanding Convertible Term Promissory Notes. In July and August 2013, GI Dynamics issued CDIs on the ASX through a private placement and SPP, which raised a total of approximately \$52.5 million, net of related expenses. In May 2014, GI Dynamics issued CDIs on the ASX through a private placement, which raised a total of approximately \$30.8 million, net of expenses. In December 2016, GI Dynamics raised approximately \$1 million, net of issuance costs, in a private placement issue of CDIs on the ASX.

In June 2017, GI Dynamics completed the 2017 Note secured financing with Crystal Amber for a gross amount of \$5 million that accrues interest at 5% per annum compounded annually. The 2017 Note was originally due on December 31, 2018 (subsequently extended multiple times as described below) and contains provisions for conversion during its term and is also subject to security arrangements in favor Crystal Amber (See Note 10 of the Consolidated Financial Statements for a more complete description of the 2017 Note terms and conditions).

In January and March 2018, GI Dynamics raised approximately \$1.6 million in a private placement of its CDIs to qualified investors, including certain existing investors, in Australia, the United States and the United Kingdom.

In May 2018, GI Dynamics closed a Note Purchase Agreement ("NPA") financing with Crystal Amber which included a Convertible Term Promissory Note (the "2018 Note") with a principal amount of \$1.75 million that accrues annually compounded interest at 10% per annum, and a related Warrant (the "2018 Warrant"). ASX Listing Rule 10.1 requires stockholder approval to issue any securities or to pledge any contingent issuances of securities to a Related Party such as Crystal Amber. The 2018 Note conversion feature and the 2018 Warrant each required stockholder approval which was obtained on May 24, 2018, in advance of the execution of the NPA. The 2018 Note was set to mature and the 2018 Warrant was set to expire on May 30, 2023, but the 2018 Note was converted in June 2019 and the 2018 Warrant was exercised in August 2019. (see Note 10 of the Consolidated Financial Statements for a more complete description of the terms and conditions).

In September 2018, GI Dynamics received commitments for a private placement of approximately \$5 million of its CDIs on the ASX to qualified investors, including certain existing investors, in Australia, the United States and the United Kingdom. The first tranche of \$2.2 million closed and cash was received in September 2018. The second and final tranche of \$2.8 million was contingent upon stockholder approval related to the issuance bringing the total securities issued during the

year to exceed the amount under which stockholder approval was not necessary. Stockholder approval was obtained in October 2018 and cash proceeds were received in November 2018.

In December 2018, the maturity date of the 2017 Note was extended to March 31, 2019 in exchange for payment of \$394 thousand which was the total accrued interest on the 2017 Note at December 31, 2018. The maturity date of the 2017 Note was extended four additional times in 2019, with the most recent being the August 21, 2019 extension of the maturity date from September 1, 2019 to March 31, 2020.

In March 2019, the Company completed a convertible term promissory note (the “March 2019 Note”) and warrant (the “March 2019 Warrant”) financing with Crystal Amber for a gross amount of \$1 million. The March 2019 Note compounded interest annually at 10% and, subject to Stockholder Approval required under ASX Listing Rules, Crystal Amber was conferred the right to optionally convert all unpaid principal and interest to CDIs at \$0.0127 per CDI before the Note Maturity date in March 2024. In conjunction with the March 2019 Note, Crystal Amber was issued a contingent warrant to purchase 78,740,157 CDIs (representing 1,574,803 shares of common stock) for \$0.0127 per CDI. The contingency of Stockholder approval was required for exercisability and after Stockholder approval was obtained on June 30, 2019, the warrant was exercisable until expiry 5 years after issuance (see Note 10 of these Consolidated Financial Statements for a more complete description of the terms and conditions of the financing).

In March 2019, the maturity date of the 2017 Note was extended to May 1, 2019. In April 2019, the maturity date of the 2017 Note was extended to July 1, 2019. Further extensions of the maturity date of the 2017 Note are described below.

In May 2019, the Company completed a convertible term promissory note (the “May 2019 Note”) and warrant (the “May 2019 Warrant”) financing with Crystal Amber for a gross amount of \$3 million. The May 2019 Note compounded interest annually at 10% and, subject to Stockholder Approval required under ASX Listing Rules, Crystal Amber was conferred the right to optionally convert all unpaid principal and interest to CDIs at \$0.0127 per CDI before the Note Maturity date in May 2024. In conjunction with the May 2019 Note, Crystal Amber was issued a contingent warrant to purchase 236,220,472 CDIs (representing 4,724,409 shares of common stock) for \$0.0127 per CDI. The contingency of Stockholder approval was required for exercisability and after Stockholder approval was obtained on June 30, 2019, the warrant was exercisable until expiry 5 years after issuance (see Note 10 of these Consolidated Financial Statements for a more complete description of the terms and conditions of the financing).

In June 2019, the maturity date of the 2017 Note was extended to October 1, 2019.

On June 30, 2019, Crystal Amber elected to convert the 2018 Note, the March 2019 Note and the May 2019 Note into CDIs. Under the terms of the respective notes, an aggregate of 453,609,963 CDIs (representing approximately 9,072,199 shares of common stock) were subscribed but unissued on conversion and concurrent cancellation of the 2018 Note, the March 2019 Note and the May 2019 Note. The CDIs were issued on July 3, 2019.

In August 2019, GI Dynamics closed the August 2019 Securities Purchase Agreement (“August SPA”) financing with Crystal Amber. The August SPA provided for approximately \$5.4 million through scheduled exercises of the 2018 Warrant, the March 2019 Warrant, and the May 2019 Warrant between August 25, 2019 and November 15, 2019. An additional investment by Crystal Amber was structured as a Convertible Term Promissory Note (the “August 2019 Note”) accruing annually compounded interest of 5% per annum and a warrant (the “August 2019 Warrant”). The August 2019 Note was to be funded at the sole discretion of the Company with respect to amount, up to approximately \$4.6 million, and timing, on or before December 6, 2019.

On August 21, 2019, the maturity date of the 2017 Note was extended to March 31, 2020.

On August 25, 2019, Crystal Amber exercised the 2018 Warrant and a portion of the March 2019 Warrant in accordance with the terms of the August 2019 SPA. For an aggregate cash payment of \$2 million, 97,222,200 CDIs (representing approximately 1,944,444 shares of common stock) were issued at \$0.0144 per CDI under the 2018 Warrant and 47,244,119 CDIs (representing approximately 944,882 shares of common stock) were issued at \$0.0127 per CDI under the March 2019 Warrant.

On September 30, 2019, Crystal Amber exercised the remaining portion of the March 2019 Warrant and a portion of the May 2019 Warrant further in accordance with the August 2019 SPA. For an aggregate cash payment of \$2 million, 31,740,704 CDIs (representing approximately 634,814 shares of common stock) were issued at \$0.0127 per CDI under the March 2019 Warrant and 125,739,610 CDIs (representing approximately 2,514,792 shares of common stock) were issued

on October 4, 2019 at \$0.0127 per CDI under the May 2019 Warrant. As of September 30, 2019, this was recorded as a subscription receivable from related party and the cash was received on October 1, 2019.

On October 31, 2019, Crystal Amber exercised another portion of the May 2019 Warrant in accordance with the August 2019 SPA. For an aggregate cash payment of \$1 million, 78,740,157 CDIs (representing approximately 1,574,803 shares of common stock) were issued on November 4, 2019 at \$0.0127 per CDI under the May 2019 Warrant. Cash was received on October 31, 2019.

On November 15, 2019, Crystal Amber exercised the final portion of the May 2019 Warrant in accordance with the August 2019 SPA. For an aggregate cash payment of approximately \$400 thousand, 31,740,748 CDIs (representing approximately 634,814 shares of common stock) were issued on November 18, 2019 at \$0.0127 per CDI under the May 2019 Warrant. Cash was received on November 15, 2019.

On December 2, 2019 GI Dynamics provided notice to Crystal Amber that the company elected to place the Note at the full amount, on or before December 6, 2019. In December, the Company and Crystal Amber agreed to confer the right to tranche the funding of the Note in amounts and per timing chosen solely by Crystal Amber, provided the August 2019 Note total was funded on or before January 15, 2020.

Prior to December 6, 2020, GI Dynamics notified Crystal Amber that it had elected to receive the full amount of approximately \$4.6 million under the August 2019 Note, but agreed to timing extensions.

On December 16, 2019, stockholder approval was obtained pursuant to ASX Listing Rule 10.11, for the August 2019 Note conversion feature and the issuance of the August 2019 Warrant, contingent on receipt of the August 2019 Note proceeds.

On January 13, 2020, the full amount of approximately \$4.6 million was received as proceeds from the August 2019 Note. On receipt of funds, the August 2019 Note conversion feature was immediately available to Crystal Amber and conferred the right to convert the August 2019 Note into CDIs at a price of \$0.02 per CDI at any time prior to the August 2019 Note maturity in August 2024. On January 13, 2020, the August 2019 Warrant was issued to Crystal Amber, conferring the right to purchase 236,220,472 CDIs (representing 4,724,409 shares of common stock) for \$0.02 per CDI. (See Note 10 of these Consolidated Financial Statements for a more complete description of the terms and conditions of the financing).

Going Concern Evaluation

As of December 31, 2019, the Company's primary source of liquidity is its cash and cash equivalents balances. GI Dynamics is currently focused primarily on its clinical trials, which will support future regulatory submissions and potential commercialization activities. Until the Company is successful in gaining regulatory approvals, it is unable to sell the Company's product in any market at this time. Without revenues, GI Dynamics is reliant on funding obtained from investment in the Company to maintain business operations until the Company can generate positive cash flows from operations. The Company cannot predict the extent of future operating losses and accumulated deficit, and it may never generate sufficient revenues to achieve or sustain profitability.

GI Dynamics has incurred operating losses since inception and at December 31, 2019, had an accumulated deficit of approximately \$284 million and a working capital deficit of \$3.2 million. The Company expects to incur significant operating losses for the next several years. At December 31, 2019 the Company had approximately \$2.5 million in cash and cash equivalents.

The Company will need to raise additional capital and restructure the terms of the 2017 Note before March 31, 2020 in order to continue to pursue its current business objectives as planned and to continue to fund its operations. The Company is looking to raise additional funds through any combination of additional equity and debt financings or from other sources. However, the Company has no guarantee that the 2017 Note will not mature on March 31, 2020 and has no guaranteed source of capital that will accommodate repayment of the 2017 Note and sustain operations past March 31, 2020. There can be no assurance that any such potential financing opportunities will be available on acceptable terms, if at all. If the Company is unable to raise sufficient capital on the Company's required timelines and on acceptable terms to stockholders and the Board of Directors, it could be forced to cease operations, including activities essential to support regulatory applications to commercialize EndoBarrier. If access to capital is not achieved in the near term, it will materially harm the Company's business, financial condition and results of operations to the extent that the Company may be required to cease operations

altogether, file for bankruptcy, or undertake any combination of the foregoing. These factors raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that these financial statements are issued.

In addition, if the Company does not meet its payment obligations to third parties as they become due, the Company may be subject to litigation claims and its credit worthiness would be adversely affected. Even if the company is successful in defending these claims, litigation could result in substantial costs and would be a distraction to management and may have other unfavorable results that could further adversely impact the Company's financial condition.

As a result of the factors described above, the Company's consolidated financial statements include a going-concern disclosure. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" for further information regarding the Company's funding requirements.

The accompanying consolidated financial statements have been prepared assuming GI Dynamics will continue as a going concern, which contemplates the realization of assets and liabilities and commitments in the normal course of business. The consolidated financial statements for the year ended December 31, 2019 do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to the Company's ability to continue as a going concern within one year after the date that the financial statements are issued.

2. Summary of Significant Accounting Policies and Basis of Presentation

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of GI Dynamics, Inc. and its wholly owned subsidiaries. All intercompany transactions and balances are eliminated in consolidation.

The functional currency of GID Europe Holding B.V., GID Europe B.V., GID Germany GmbH and GI Dynamics Australia Pty Ltd is the U.S. dollar. Consolidated balance sheet accounts of the Company's subsidiaries are remeasured into U.S. dollars using the exchange rate in effect at the consolidated balance sheet date while expenses are remeasured using the average exchange rate in effect during the period. Gains and losses arising from remeasurement of the wholly owned subsidiaries' financial statements are included in the determination of net loss.

Use of Estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles in the U.S. requires the Company's management to make estimates and judgments that may affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, inventory valuation including reserves for excess and obsolete inventory, impairment of long-lived assets, income taxes including the valuation allowance for deferred tax assets, research and development, contingencies, valuation of warrant liabilities, estimates used to assess its ability to continue as a going concern and stock-based compensation. GI Dynamics bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. Changes in estimates are reflected in reported results in the period in which they become known.

Cash, Cash Equivalents and Restricted Cash

GI Dynamics considers all highly liquid investment instruments with an original maturity when purchased of three months or less to be cash equivalents. Investments qualifying as cash equivalents primarily consist of money market funds and have a carrying amount that approximates fair value. The amount of cash equivalents included in cash and cash equivalents was approximately \$0 and \$1.1 million at December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, GI Dynamics had approximately \$2 and \$71 thousand, respectively, of cash and cash equivalents denominated in Australian dollars or Euros that is subject to foreign currency gain and loss.

GI Dynamics has \$30 thousand in restricted cash used to secure a corporate credit card account.

Inventory

When the Company gains regulatory approval to resume commercial activity, inventory will be stated at the lower of first-in, first-out cost or net realizable value. When capitalizing inventory, the Company will consider factors such as status of regulatory approval, alternative use of inventory, and anticipated commercial use of the product. At December 31, 2019 and 2018, there was no inventory.

Property and Equipment

Property and equipment, are recorded at cost and are depreciated when placed in service using the straight-line method based on their estimated useful lives as follows:

<u>Asset Description</u>	<u>Estimated Useful Life</u> (In Years)
Laboratory and manufacturing equipment	5
Computer equipment and software	3
Office furniture and equipment	5

Included in property and equipment are certain costs of software obtained for internal use. Costs incurred during the preliminary project stage are expensed as incurred, while costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software. GI Dynamics also capitalizes costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Maintenance and training costs related to software obtained for internal use are expensed as incurred.

Leasehold improvements are amortized over the shorter of the estimated useful life of the asset or the remaining lease term. Costs for capital assets not yet placed into service have been capitalized as construction in progress and will be depreciated in accordance with the above guidelines once placed into service. Maintenance and repair costs are expensed as incurred.

Lease Liabilities and Related Assets

The Company adopted Accounting Standards Codification (“ASC”), Topic 842, *Leases* (“ASC 842”) on January 1, 2019, but had no long-term leases to which it would apply. In May 2019, the Company entered into the first right-of-use Lease requiring the adoption of ASC 842.

At the inception of an arrangement, the Company determines whether the arrangement is or contains a lease based on the unique facts and circumstances present. The Company has elected not to recognize on the balance sheet leases with terms of one year or less. Leases with a non-cancellable term greater than one year are recognized on the balance sheet as lease assets, short-term lease liabilities and long-term lease liabilities. Using criteria defined in ASC 842, the Company determines whether the lease is a Financing Lease or an Operating Lease.

Lease liabilities and their corresponding right-of-use assets are recorded based on the present value of lease payments over the expected remaining lease term. Options to renew an Operating lease are not included in the Company’s initial lease term assessment unless there is reasonable certainty that the Company will renew. However, certain adjustments to the right-of-use operating asset may be required for items such as incentives received. The interest rate implicit in lease contracts is typically not readily determinable. As a result, the Company utilizes an estimated incremental borrowing rate, which is the rate it is expected to incur to borrow an amount equal to the lease payments on a collateralized basis (or on an unsecured basis if existing debt covenants prevent further securitization) over a similar term in a similar economic environment.

Revenue Recognition

GI Dynamics recorded no revenues for the year ended December 31, 2019 or 2018. For the year ended December 31, 2017, the Company had revenues of \$53 thousand of sales of EndoBarrier directly to health care providers or to third-party distributors who resell to health care providers. The Company’s January 2018 adoption of ASC 606 required the Company

to follow a multi-step process to determine the elements of the implied contract with the customer when it sells and supports its products. The steps followed are to:

- Identify the implied contract with the customer: A contract exists with a customer when an authorized purchase order is submitted, placing a binding order with the Company such that transfer of the product and/or services, including any implied performance obligations on the part of the Company, commits to a sale of goods (Goods sold, “G/S”) and the expectation to receive consideration for the G/S.
- Identify the explicit and implicit performance obligations within the contract: The Company’s G/S offering includes an underlying product and closely related ongoing technical support for the product and its use. Assurance warranties offering a right of return for defective products are excluded from the contractual performance obligations under ASC 606. Technical support, as the remaining performance obligations does not have standalone value as it is only available for the Company’s product and only to those who have purchased and are using the Company’s product.
- Determine the transaction price: The new guidance defines the transaction price as the expected amount to be received for G/S. This includes probability and magnitude of customer discounts, any expected collection risk, and any additional factors which may reduce the ultimate amount expected to be received. Estimates of these expected amounts will be based on established pricing and historical patterns once captured and management judgement until sufficient historical data is available.
- The transaction price is allocated to the product and performance obligations of the contract: The allocation price will be allocated to the various G/S components, especially to any performance obligations that remain after product delivery or product implantation. In the Company’s current model, the transfer of title of the product occurs on customer receipt of shipment; product invoicing will occur after shipment and collectability expectations will be confirmed or adjusted after a sufficient period to gauge likelihood of eventual collection; and the technical support is present from shipment and is discharged after successful EndoBarrier sleeve retrieval (approximately one year after successful implantation).
- As the performance obligations are discharged, the associated allocated portion of the revenue will be recognized. In our current model, the Company expect to book a) revenue associated with the product allocation on shipment of the product, b) revenue associated with any true up/adjustment to collectability as payment is received or when non-payment is probable, and c) revenue associated with technical support is discharged when the EndoBarrier is successfully retrieved from the patient.

Product Shipping and Handling Costs

Shipping and handling costs are included in costs of revenue as they are not a performance obligation of the contract with the customer as shipping is our expense and occurs prior to title transfer of the product.

Research and Development Costs

Research and development costs are expensed when incurred. Research and development costs include costs of all basic research activities as well as other research, engineering, and technical effort required to develop a new product or service or make significant improvement to an existing product or manufacturing process. Research and development costs also include preapproval regulatory and clinical trial expenses.

Patent Costs

GI Dynamics expenses as incurred all costs, including legal expenses, associated with obtaining patents until the patented technology becomes feasible. All costs incurred after the patented technology is feasible will be capitalized as an intangible asset. As of December 31, 2019, no such costs had been capitalized since inception of the Company. GI Dynamics has expensed approximately \$200 thousand of patent costs within general and administrative expenses in the consolidated statements of operations for each year ended December 31, 2019 and 2018.

Stock-Based Compensation

GI Dynamics accounts for stock-based compensation in accordance with the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, 718, *Stock Compensation*, or ASC 718, which requires that stock-

based compensation be measured and recognized as an expense in the financial statements and that such expense be measured at the grant date fair value.

For awards that vest based on service conditions, we use the straight-line method to allocate compensation expense to reporting periods. The grant date fair value of options granted is calculated using the Black-Scholes option pricing model, which requires the use of subjective assumptions including volatility, expected term and the fair value of the underlying common stock, among others.

The assumptions used in determining the fair value of stock-based awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change, and management uses different assumptions, the Company's stock-based compensation could be materially different in the future. The risk-free interest rate used for each grant is based on a zero-coupon U.S. Treasury instrument with a remaining term similar to the expected term of the stock-based award. Because GI Dynamics does not have a sufficient stable history to estimate the expected term, it uses the simplified method for estimating the expected term. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. Because there was no public market for GI Dynamics common stock prior to our IPO, GI Dynamics lacked company-specific historical and implied volatility information. The Company does have approximately 6 years of historical price volatility since its IPO in September 2011. Therefore, management estimates the expected stock volatility based on the to-date historical price volatility. GI Dynamics has not paid and does not anticipate paying cash dividends on its shares of common stock; therefore, the expected dividend yield is assumed to be zero.

GI Dynamics elected to adopt ASU 2016-09 in the first quarter of 2017, subsequently recognizing the impact of share-based award forfeitures only as they occur rather than by applying an estimated forfeiture rate as previously required. Adoption resulted in the recording of a decrease to accumulated deficit of approximately \$28 thousand with an offset to Additional Paid in Capital in 2017.

GI Dynamics periodically issues performance-based awards. For these awards, vesting will occur upon the achievement of certain milestones. When achievement of the milestone is deemed probable, the Company records as compensation expense, the value of the respective stock award over the implicit remaining service period.

Stock awards to non-employees are accounted for in accordance with ASC 505-50, *Equity-Based Payments to Non-Employees* ("ASC 505-50"). The measurement date for non-employee awards is generally the date performance of services required from the non-employee is complete. For non-employee awards that vest based on service conditions, GI Dynamics expenses the value of the awards over the related service period, provided the Company expects the service condition to be met. The Company records the expense of services rendered by non-employees based on the estimated fair value of the stock option using the Black-Scholes option pricing model over the contractual term of the non-employee. The fair value of unvested non-employee awards is remeasured at each reporting period and expensed over the vesting term of the underlying stock options on a straight-line basis.

Impairment of Long-Lived Assets

GI Dynamics regularly reviews the carrying amount of its long-lived assets to determine whether indicators of impairment may exist that merit adjustments to carrying values or estimated useful lives. If indications of impairment exist, projected future undiscounted cash flows associated with the asset are compared to the carrying amount to determine whether the asset's value is recoverable. If the carrying value of the asset exceeds such projected undiscounted cash flows, the asset will be written down to its estimated fair value. No such impairments were recorded in 2019 or 2018.

Loss Contingencies

In accordance with ASC 450, *Contingencies*, GI Dynamics accrues anticipated costs of settlement, damages, and losses for loss contingencies based on historical experience or to the extent specific losses are probable and estimable. Otherwise, the Company expenses these costs as incurred. If the estimate of a probable loss is a range, and no amount within the range is more likely, GI Dynamics accrues the minimum amount of the range. No loss contingencies were recorded on the balance sheet as of December 31, 2019 or 2018.

Fraudulent Diversion of Funds and Related Insurance Proceeds

In July 2018, after a third-party investigation isolated the activity, an insurance claim was filed for \$271 thousand for fraudulent diversion of cash from the Company's account into a personal account that occurred during the years 2016 through 2018. In 2017, an entry aggregated and reclassified the fraudulent expenses totaling \$170 thousand from operating expenses to the other income account entitled income (expense) from insurance proceeds. Expense in the year ended December 31, 2017 represents fraudulent activity comprised of \$37 thousand of research and development, \$10 thousand of sales and marketing and \$123 thousand of general and administrative expense and income in the year ended December 31, 2018 represents net insurance proceeds on the claim less \$22 thousand of research and development expense. GI Dynamics has since implemented internal controls to correct the identified control deficiencies associated with the fraud and the employee responsible for the diverted funds is no longer with the Company.

Income Taxes

GI Dynamics provides for income taxes under the liability method. The Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between its financial reporting and the tax bases of assets and liabilities measured using the enacted tax rates expected to be in effect in the years in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization.

The Company accounts for uncertain tax positions recognized in the consolidated financial statements by applying a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Guarantees

GI Dynamics has identified the guarantees described below as disclosable, in accordance with ASC 460, *Guarantees*.

As permitted under Delaware law, GI Dynamics indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company's request in such capacity. The maximum potential amount of future payments the Company could be required to make is unlimited; however, the Company maintains directors' and officers' insurance coverage that should limit its exposure and enable it to recover a portion of any future amounts paid.

GI Dynamics is a party to a number of agreements entered into in the ordinary course of business that contain typical provisions that obligate it to indemnify the other parties to such agreements upon the occurrence of certain events. Such indemnification obligations are usually in effect from the date of execution of the applicable agreement for a period equal to the applicable statute of limitations. The aggregate maximum potential future liability of the Company under such indemnification provisions is uncertain.

As of December 31, 2019, and 2018, GI Dynamics had not experienced any material losses related to these indemnification obligations, and no material claims with respect thereto were outstanding. The Company does not expect significant claims related to these indemnification obligations and, consequently, concluded that the fair value of these obligations is negligible. As a result, no related reserves have been established.

Issuance Costs Related to Equity and Debt

The Company allocates issuance costs between the individual freestanding instruments identified on the same basis as proceeds were allocated. Issuance costs associated with the issuance of stock or equity contracts (i.e., equity-classified warrants and convertible preferred stock) are recorded as a charge against the gross proceeds of the offering. Any issuance costs associated with the issuance of liability-classified warrants are expensed as incurred. Issuance costs associated with the issuance of debt (i.e., convertible debt) is recorded as a direct reduction of the carrying amount of the debt liability but limited to the notional value of the debt. The Company accounts for debt as liabilities measured at amortized cost and amortizes the resulting debt discount to interest expense using the effective interest method over the expected term of the notes pursuant to ASC 835, *Interest* ("ASC 835"). To the extent that the reduction from issuance costs of the carrying amount of the debt liability would reduce the carrying amount below zero, such excess is recorded as interest expense.

Embedded Conversion Features

The Company evaluates embedded conversion features within convertible debt under ASC 815, *Derivatives and Hedging* to determine whether the embedded conversion feature(s) should be bifurcated from the host instrument and accounted for as a derivative at fair value with changes in fair value recorded in earnings. If the conversion feature does not require derivative treatment under ASC 815, the instrument is evaluated under ASC 470-20 “Debt with Conversion and Other Options.” Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. The effect of ASC 470-20 on the accounting for the Company convertible debt instruments is that the equity component is required to be included in the additional paid-in capital section of stockholders’ equity on the consolidated balance sheets and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component of the notes. Therefore, the Company is required to record as non-cash interest expense the amortization of the discounted carrying value of the convertible debt to the face amount over the term of the convertible debt. The Company reports higher interest expense in the Company’s financial results because ASC 470-20 requires interest to include both the current period’s amortization of the debt discount and the instrument’s coupon interest.

For conventional convertible debt where the rate of conversion is below market value, the Company values and records a beneficial conversion feature (“BCF”) and related debt discount on issuance. When the Company records a BCF, the relative fair value of the BCF is recorded as a debt discount against the face amount of the respective debt instrument (offset to additional paid in capital) and amortized to interest expense over the life of the debt.

Reclassification

On the consolidated statement of cash flows, the Company reclassified amortization of debt issuance costs to non-cash interest expense of \$156 thousand and accretion of debt discount of \$168 thousand into non-cash interest expense for the year ended December 31, 2018 in order to conform with current year presentation.

Subsequent Events

GI Dynamics evaluates events occurring after the date of its consolidated balance sheet for potential recognition or disclosure in its consolidated financial statements. On January 13, 2020, GI Dynamics received approximately \$4.6 million pursuant to the August 2019 Note. On receipt of funds, the August 2019 Note became convertible per the August 2019 Note terms (as disclosed within the relevant footnotes), and GI Dynamics issued the August 2019 Warrant (as disclosed within the relevant footnotes).

New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842), or ASU 2016-02. ASU 2016-02 requires that most operating leases be recorded on the balance sheet unless the practical expedient is elected for short-term operating leases. The lessee will record a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis, and a right-of-use asset, which is an asset representing the lessee’s right to use the underlying asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees may not apply a full retrospective transition approach. The Company elected to apply the practical expedient as it relates to short-term leases. The Company adopted ASU 2016-02 on January 1, 2019. There was no impact to retained earnings upon adoption as there were no long-term leases in effect at adoption (see Note 11 of these Consolidated Financial Statements for a more complete description of the lease accounting and impacts of adoption).

In June 2018, the FASB issued ASU No. 2018-07, *Compensation – Stock Compensation* (Topic 718: *Improvements to nonemployee share-based payment accounting*), or ASU 2018-07, which provides measurement provisions and clarifications for the accounting for Non-employee Share-Based Payments (“NESBP”). As a result, most of the guidance within ASC 718 associated with employee share-based payments, including most of its requirements related to classification and measurement, applies to NESBP. ASU 2018-07 is effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted but not in advance of adoption of Topic 606, *Revenue Recognition*. Upon

transition, the entity is required to measure these nonemployee awards at fair value as of the adoption date. The entity must not remeasure assets that are completed. The Company adopted ASC 2018-07 as of January 1, 2019 and there was no impact to retained earnings or equity as no uncompleted NESBPs were outstanding when adopted. For the year ended December 31, 2019, the Company had no unvested or unearned NESBPs outstanding.

In July 2018, the FASB issued ASU No. 2018-09, *Codification Improvements*, or ASU 2018-09, which affects a wide variety of topics, including the following: Amendments to Subtopic 220-10, *Income Statement—Reporting Comprehensive Income—Overall* relates to income taxes not payable in cash; Amendments to Subtopic 470-50, *Debt—Modifications and Extinguishments* relates to debt extinguishment and requires that the net carrying amount of extinguished fair value elected debt equals its fair value at reacquisition and related gains or losses in other comprehensive income must be included in net income upon extinguishment of the debt; Amendments to Subtopic 480-10, *Distinguishing Liabilities from Equity—Overall* relates to combinations of freestanding financial instruments with non-controlling interests; Amendments to Subtopic 718-740, *Compensation—Stock Compensation—Income Taxes* relate to recognition timing clarification for excess tax benefits or deficiencies for compensation expense; Amendments to Subtopic 805-740, *Business Combinations—Income Taxes* relate to allocating tax provisions to an acquired entity; Amendments to Subtopic 815-10, *Derivatives and Hedging—Overall* relate to accounting for offsetting derivatives; Amendments to Subtopic 820-10, *Fair Value Measurement—Overall* relate to the wording with respect to how transfer restrictions effect the fair value of an asset and adds explicit wording to allow entities to measure fair value on a net basis for those portfolios in which financial assets and financial liabilities and nonfinancial instruments are managed and valued together. Amendments to Subtopic 940-405, *Financial Services—Brokers and Dealers—Liabilities* relate to guidance about offsetting on the balance sheet; and Amendments to Subtopic 962-325, *Plan Accounting—Defined Contribution Pension Plans—Investments—Other* relate to plan evaluation of whether a readily determinable fair value exists to determine whether those investments may qualify for the practical expedient to measure at net asset value in accordance with Topic 820. The transition and selection of an effective date is based on the facts and circumstances of each amendment, but many of the amendments have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. The Company is currently evaluating the relevance of each components and potential impact of ASU 2018-09 components to its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, or ASU 2018-13, which provides guidance focused on the disclosure requirements for disclosing fair value estimates, assumptions, and methodology. Requirements removed include the requirement to disclose details around amount and reasoning for level 1 to level 2 transfers, timing policies for transfer between levels and the valuation processes for level 3 fair value measurements. Modified requirements include details regarding net asset redemption restrictions and timing related to uncertainty disclosures. Requirements added include disclosures of changes in unrealized gains and losses for recurring level 3 measurements held as of the reporting date and disclosures around the range and weighted average of significant inputs used to develop level 3 fair value measurements. These amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance of this update. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this update and delay adoption of the additional disclosures until their effective date. The Company is currently evaluating the individual components and as these are disclosure refinements, expects no impact to its consolidated financial statements on adoption.

3. Net Loss per Common Share

Basic net loss per common share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. Potential common stock equivalents are determined using the treasury stock method. For diluted net loss per share purposes, stock options and other stock-based awards are excluded, including shares issued as a result of option exercises but which are subject to repurchase by the Company, whose effect would be anti-dilutive from the calculation. For diluted net loss per share purposes, warrants conferring the right to purchase common shares and because CDIs and common shares are interchangeable at the election of the stockholder, warrants conferring the right to purchase

CDIs are excluded from diluted net loss per share calculations as inclusion would have an anti-dilutive effect. During each of the years ended December 31, 2019 and 2018, common stock equivalents were excluded from the calculation of diluted net loss per common share, as their effect was anti-dilutive due to the net loss incurred. Therefore, basic and diluted net loss per share was the same in all periods presented.

The following potentially dilutive securities have been excluded from the computation of diluted weighted- average shares outstanding as of December 31, 2019 and 2018, as they would be anti-dilutive:

	Years Ended December 31,	
	2019	2018
Warrants to purchase common stock	2,238,149	1,972,976
Options to purchase common stock and other stock-based awards	3,266,154	1,545,719
Total	5,504,303	3,518,695

4. Common Stock and CDI Warrants

On May 4, 2016, GI Dynamics entered into a consulting agreement pursuant to which the consulting firm would provide strategic advisory, finance, accounting, human resources and administrative functions, including chief financial officer services, to the Company. In connection with the consulting agreement, the Company granted the consulting firm a warrant (“Consultant Warrant”) to purchase up to 28,532 shares of GI Dynamics common stock at an exercise price per share equal to \$0.64. The Consultant Warrant vested on a monthly basis over two years and has a term of five years. The Company has reserved 28,532 shares of common stock related to the fully vested Consultant Warrant. As of December 31, 2019, no Consultant Warrants had been exercised.

GI Dynamics accounts for the warrant under ASC 815, *Derivatives and Hedging* (“ASC 815”). In accordance with the guidance included in ASC 815, because the warrant agreement contains a cashless exercise provision, the warrant is deemed a derivative financial instrument and must be recorded as a derivative liability to be remeasured at every reporting period. At the time the warrants were issued, the Company estimated the fair value of the warrants using the Black-Scholes option pricing model. The Company remeasured the fair value of the warrants at each reporting period using current assumptions and current foreign exchange rates, with changes in value recorded as other income or expense (Note 5).

On May 24, 2018, pursuant to the 2018 Note Purchase Agreement between GI Dynamics and Crystal Amber and having obtained the necessary GI Dynamics stockholder approval required by ASX Listing Rule 10.11, GI Dynamics issued to Crystal Amber a warrant (the “2018 Warrant”) to purchase 97,222,200 CDIs (representing 1,944,444 shares of common stock) for an initial exercise price of \$0.018 per CDI. In November 2018, the exercise price was subsequently adjusted to \$0.0144 per CDI, triggered by the Company’s sale of CDIs to investors for \$0.0144 per CDI. On August 25, 2019, the 2018 Warrant was exercised in full for \$1.4 million.

On March 15, 2019, GI Dynamics entered into the March 2019 Note Purchase Agreement between GI Dynamics and Crystal Amber, which included the contingent issuance of a warrant (the “March 2019 Warrant”) to purchase 78,984,823 CDIs (representing 1,579,696 shares of common stock) for an exercise price of \$0.0127 per CDI. The March 2019 Note was issued and funded prior to obtaining the stockholder approval required by ASX Listing Rule 10.11 to issue the March 2019 Warrant.

On May 8, 2019, GI Dynamics entered into the May 2019 Note Purchase Agreement between GI Dynamics and Crystal Amber, which included the contingent issuance of a warrant (the “May 2019 Warrant”) to purchase 236,220,472 CDIs (representing 4,724,409 shares of common stock) for an exercise price of \$0.0127 per CDI. The May 2019 Note was issued and funded prior to obtaining the stockholder approval required by ASX Listing Rule 10.11 to issue the May 2019 Warrant.

On June 30, 2019, pursuant to the March 2019 Note Purchase Agreement between GI Dynamics and Crystal Amber and having obtained the necessary GI Dynamics stockholder approval, GI Dynamics issued to Crystal Amber a warrant (the “March 2019 Warrant”) to purchase 78,984,823 CDIs (representing 1,579,696 shares of common stock) for an exercise price of \$0.0127 per CDI. On August 25, 2019, a portion of the March 2019 Warrant totaling 47,244,119 CDIs (equivalent to approximately 944,882 shares of common stock) was exercised for approximately

\$600 thousand. On September 30, 2019, the remaining portion of the March 2019 Warrant, totaling 31,740,704 CDIs (equivalent to 634,814 shares of common stock) was exercised for approximately \$400 thousand.

On June 30, 2019, pursuant to the May 2019 Note Purchase Agreement between GI Dynamics and Crystal Amber and having obtained the necessary GI Dynamics stockholder approval, GI Dynamics issued to Crystal Amber a warrant (the “May 2019 Warrant”) to purchase 236,220,472 CDIs (representing 4,724,409 shares of common stock) for an exercise price of \$0.0127 per CDI. On September 30, 2019, a portion of the May 2019 Warrant totaling 125,739,610 CDIs (equivalent to 2,514,792 shares of common stock) was exercised by Crystal Amber, a Related Party, for approximately \$1.6 million. On October 31, 2019, another portion of the May 2019 Warrant totaling 78,740,157 CDIs (equivalent to 1,574,803 shares of common stock) was exercised by Crystal Amber, a Related Party, for approximately \$1 million. On November 15, 2019, the final portion of the May 2019 Warrant totaling 31,740,704 CDIs (equivalent to 634,814 shares of common stock) was exercised for approximately \$400 thousand.

On August 21, 2019, GI Dynamics and Crystal Amber entered into an SPA for a total funding of up to approximately \$10 million (the “August 2019 SPA”) comprised of the scheduled exercise of the 2018 Warrant, the March 2019 Warrant, and the May 2019 Warrant as detailed above and the sale of an Unsecured Convertible Note for up to approximately \$4.6 million (the “August 2019 Note”), which included the contingent issuance of a warrant (the “August 2019 Warrant”) to purchase up to 229,844,650 CDIs (representing 4,596,893 shares of common stock) for an exercise price of \$0.02 per CDI. The contingencies included the funding of the August 2019 Note and stockholder approval required by ASX Listing Rule 10.11. On December 16, 2019, stockholder approval for a warrant conferring the right to purchase up to 229,844,650 CDIs (representing 4,596,893 shares of common stock) for an exercise price of \$0.02 per CDI was obtained. The August 2019 Note was funded for the maximum amount of approximately \$4.6 million on January 13, 2020. On January 13, 2020, GI Dynamics issued to Crystal Amber the August 2019 Warrant to purchase 229,844,650 CDIs (representing 4,596,893 shares of common stock) for an exercise price of \$0.02 per CDI.

5. Fair Value Measurements

The tables below present information about the Company’s assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2019 and 2018 and indicates the fair value hierarchy of the valuation techniques the Company used to determine such fair value. In general, fair values determined by Level 1 inputs utilize observable inputs such as quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are either directly or indirectly observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points in which there is little or no market data, requiring the Company to develop its own assumptions for the asset or liability.

The following tables present the assets and liabilities the Company has measured at fair value on a recurring basis (in thousands):

			Fair Value Measurements at Reporting Date Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description	December 31, 2019				
Assets					
Money market funds (included in cash and cash equivalents)	\$ —		\$ —	\$ —	\$ —
Total assets	\$ —		\$ —	\$ —	\$ —
Liabilities					
Warrant liability	\$ 10		\$ —	\$ —	\$ 10
Total liabilities	\$ 10		\$ —	\$ —	\$ 10
			Fair Value Measurements at Reporting Date Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description	December 31, 2018				
Assets					
Money market funds (included in cash and cash equivalents)	\$ 1,097		\$ 1,097	\$ —	\$ —
Total assets	\$ 1,097		\$ 1,097	\$ —	\$ —
Liabilities					
Warrant liability	\$ 51		\$ —	\$ —	\$ 51
Total liabilities	\$ 51		\$ —	\$ —	\$ 51

The assumptions used in the Black-Scholes option pricing model to determine the fair value of the Derivative Liabilities, the Consultant Warrant, at December 31, 2019 and 2018 were as follows:

	December 31,	
	2019	2018
Exercise price (A\$55.00 at the then current exchange rate)	\$0.64	\$0.64
Fair value of common stock	\$0.62	\$0.57
Expected volatility	130.0%	134.0%
Expected term (in years)	1.35	2.35
Risk-free interest rate	1.59%	2.48%
Expected dividend yield	—%	—%

The conversion feature associated with the 2017 Note (detailed below in Note 10) was valued using a financial model with unobservable inputs relating to volatility, variable outcomes and projected stock values. This model incorporated assumptions similar to those used to value the common stock warrants with the primary difference being a change in the expected term to reflect the contractual terms of the debt instrument.

The following table rolls forward the fair value of the derivative liabilities, where fair value is determined by Level 3 inputs (in thousands):

Balance at December 31, 2017	\$ 493
Decrease in fair value of 2017 Note-related conversion feature upon re-measurement	(464)
Decrease in fair value of warrants upon re-measurement	(18)
Fair value of beneficial conversion feature discount associated with 2017 Note modification	40
Balance at December 31, 2018	\$ 51
Decrease in fair value of warrants upon re-measurement	(41)
Balance at December 31, 2019	\$ 10

Cash, cash equivalents, restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses, short-term debt to related party and other current liabilities at December 31, 2019 and 2018 are carried at amounts that approximate fair value due to their short-term maturities and highly liquid nature of these instruments.

6. Concentrations of Credit Risk, Accounts Receivable and Related Valuation Account

Financial instruments that subject GI Dynamics to credit risk primarily consist of cash and cash equivalents, restricted cash and accounts receivable. Cash and cash equivalent balances are all maintained with high quality financial institutions, and consequently, the Company believes that such funds are subject to minimal credit risk. The Company's short-term investments potentially subject the Company to concentrations of credit risk. GI Dynamics has adopted an investment policy that limits the amounts it may invest in any one type of investment and requires all held investments to hold at least an A rating from a recognized credit rating agency, thereby reducing credit risk concentration.

GI Dynamics reversed a \$42 thousand allowance for doubtful accounts balance in 2018, resulting in no accounts receivable and allowance of doubtful accounts balances at December 31, 2019 or 2018. As such, there is no credit risk from receivables.

7. Inventory

GI Dynamics states inventory at the lower of first-in, first-out cost or net realizable value. The Company records a provision for excess, expired, and obsolete inventory based primarily on estimates of forecasted revenues. When capitalizing inventory, factors such as status of regulatory approval, alternative use of inventory, and anticipated commercial use of the product are considered. Given the probability and timing of regulatory approval and appropriate inventory life span, the Company fully reserved its inventory as of December 31, 2017 and subsequently wrote off all inventory and reserves in 2018 as the materials on hand were not expected to be usable for future sales. There is no inventory or reserves against inventory on the balance sheet at December 31, 2019.

8. Property and Equipment

Property and equipment consisted of the following (in thousands):

	December 31,	
	2019	2018
Laboratory and manufacturing equipment	\$ 591	\$ 591
Computer equipment and software	1,193	1,182
Office furniture and equipment	183	183
	1,967	1,956
Less accumulated depreciation and amortization	(1,925)	(1,893)
Total	\$ 42	\$ 63

The Company recorded a loss on disposal of \$2 thousand in connection with the expiration of its office lease and the related leasehold improvements on April 13, 2018.

At December 31, 2019 and 2018, the Company had no property and equipment assets financed in any capital lease arrangement.

Depreciation and amortization expense of property and equipment totaled approximately \$32 thousand and \$35 thousand for the years ended December 31, 2019 and 2018.

9. Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	December 31,	
	2019	2018
Payroll and related liabilities	\$ 579	\$ 386
Professional fees	234	573
Credit refunds	164	186
Interest payable	250	494
Other	65	6
Total	\$ 1,292	\$ 1,645

In 2017, following the notification by MHRA, the Company notified its customers to return their inventory on hand. The Company calculated an estimate for returns, reversed its revenue and recorded an accrued expense estimate of \$202 thousand of product return related costs in addition to \$77 thousand of credit memos granted to customers. No related activity in 2018 and 2019 resulted in the amounts being unchanged and the Company still anticipates claims against these accruals in the future.

In 2017, the Company recorded \$136 thousand of interest payable on the 2017 Note. In 2018, the Company recorded \$359 thousand of interest payable on the 2017 and 2018 Notes. In December 2018, the maturity of the 2017 Note was extended to March 31, 2019 in exchange for payment of \$394 thousand which was the total accrued interest on the 2017 Note at December 31, 2018.

10. Notes Payable

2017 Convertible Note Financing

On June 15, 2017, the Company entered into a Note Purchase Agreement (“2017 NPA”) by and between the Company and Crystal Amber. Pursuant to the 2017 NPA, the Company issued and sold to Crystal Amber, a Senior Secured Convertible Promissory Note in an aggregate original principal amount of \$5.0 million (the “2017 Note”).

The 2017 Note accrues interest at an annually compounded rate of 5% per annum, other than during the continuance of an event of default, when the 2017 Note accrues interest at a rate of 8% per annum. The entire outstanding principal

balance and all unpaid accrued interest thereon was initially due on the original maturity date of December 31, 2018, but the maturity date was extended multiple times as described below.

The 2017 Note is secured by a first priority security interest in substantially all tangible and intangible assets of the Company, including intellectual property (the “Collateral”). In the event of an uncured default, Crystal Amber, a Related Party, is authorized to sell, transfer, assign or otherwise deal in or with the Collateral or the proceeds thereof or any related goods securing the Collateral, as fully and effectually as if Crystal Amber, a Related Party, were the absolute owner thereof.

The ASX provided the Company with a waiver to allow all asset liens (the “Security”) to be granted to Crystal Amber, without the customary requirement of having to obtain stockholder approval for the grant of a security to a Related Party of the Company. As a result of the waiver, the Security contains a provision that provides that if an event of default occurs and Crystal Amber exercises its rights under the Security, neither Crystal Amber nor any of its associates can acquire any legal or beneficial interest in an asset of the Company or its subsidiaries in full or partial satisfaction of the Company’s obligations under the Security, or otherwise deal with the assets of the Company or its subsidiaries, without the Company first having complied with any applicable ASX Listing Rules, including ASX Listing Rule 10.1, other than as required by law or through a receiver, manager, or analogous person appointed by Crystal Amber exercising its power of sale under the Security and selling the assets to an unrelated third party on arm’s length commercial terms and conditions and distributing the cash proceeds to Crystal Amber or any of its associates in accordance with their legal entitlements.

The 2017 Note was issued without stockholder approval of certain specific conversion features and as a consequence, Crystal Amber had no right to exercise any note conversion rights until stockholders approved the 2017 Note conversion terms on May 24, 2018. Subsequently, the entire outstanding principal balance under the 2017 Note and all unpaid accrued interest thereon is convertible into CDIs (i) prior to the maturity date, at the option of Crystal Amber at a conversion price calculated based on the five-day volume weighted average price of the Company’s CDIs traded on the ASX (“Optional Conversion Price”), or (ii) automatically upon the occurrence of an equity financing in which the Company raises at least \$10 million (a “Qualified Financing”) at the price per CDI of the CDIs issued and sold in such financing.

In the event that the Company issues additional CDIs in a subsequent equity financing at a price per CDI that is less than the then-effective Optional Conversion Price, Crystal Amber has a 30-day option to convert at an adjusted conversion price reflecting, on a weighted average basis, the lower price per CDI. The number of CDIs that Crystal Amber may acquire upon conversion of the 2017 Note at this adjusted conversion price is limited to the number that maintains Crystal Amber’s fully-diluted ownership percentage of the Company at the same level as existed immediately preceding the applicable subsequent equity financing.

In addition, upon a change of control of the Company (other than a change of control resulting from a Qualified Financing) in which the Company’s stockholders receive cash consideration, the Company is obligated under the 2017 Note to pay all accrued and unpaid interest then due plus 110% of the remaining outstanding unconverted principal balance. If the change of control results in non-cash consideration, Crystal Amber may convert the entire outstanding principal balance under the 2017 Note and all unpaid accrued interest then due into CDIs at the abovementioned Optional Conversion Price. Other than as described above, the Company may not prepay the 2017 Note without the consent of Crystal Amber.

The 2017 NPA contains customary events of default including a failure to perform obligations under the 2017 NPA, bankruptcy, a decision by the board of directors of the Company to wind up the Company, or if the Company otherwise ceases to carry on its ongoing business operations. If a default occurs and is not cured within the applicable cure period or is not waived, any outstanding obligations under the 2017 Note may be accelerated. The 2017 NPA and related 2017 Note documents also contain additional representations and warranties, covenants and conditions, in each case customary for transactions of this type.

The Company recorded the \$5 million 2017 Note, net of debt issuance costs of \$115 thousand and amortized the debt issuance costs over the life of the 2017 Note.

In December 2018, the maturity date of the 2017 Note was extended to March 31, 2019 in exchange for payment of \$394 thousand, which was the total interest accrued on the 2017 Note at December 31, 2018. Payment of this amount was made in January 2019. The modification extended the conversion rights and resulted in an additional \$40 thousand of debt discount liability being recorded along with issuance costs of \$53 thousand.

In March 2019, the maturity date of the 2017 Note was extended to May 1, 2019. The modification resulted in a revaluation of the conversion feature to be recorded in the debt discount liability, which was not recorded since it was determined to be immaterial to the consolidated financial statements. In April 2019, the maturity date of the 2017 Note was further extended to July 1, 2019, which resulted in a revalued conversion feature recorded as \$24 thousand of debt discount liability. In June 2019, the maturity date of the 2017 Note was further extended to October 1, 2019, which resulted in a revalued conversion feature recorded as \$31 thousand of debt discount liability. On August 21, 2019 the maturity date of the 2017 Note was further extended to March 31, 2020, which resulted in a revalued conversion feature recorded as \$273 thousand of debt discount liability.

As of December 31, 2019 and 2018, the Company accrued interest expense of \$250 and \$257 thousand and amortization of the debt discount to interest expense of \$309 thousand and nil, respectively, related to the 2017 Note. For the years ended December 31, 2019 and 2018, the Company recorded amortization of debt issuance costs of \$56 and \$71 thousand, respectively, related to the 2017 Note. For the year ended December 31, 2018, the Company also recorded interest of \$464 thousand related to the conversion rights.

2018 Convertible Note and Warrant Financing

On May 30, 2018, the Company entered into a Note Purchase Agreement (“2018 NPA”) by and between the Company and Crystal Amber. Pursuant to the 2018 NPA, the Company issued and sold to Crystal Amber a Senior Unsecured Convertible Promissory Note in an aggregate original principal amount of \$1.8 million (the “2018 Note”) with a maturity date of May 30, 2023. Interest accrued at an annually compounded rate of 10% per annum.

On May 30, 2018, having secured stockholder pre-approval of the conversion features on May 24, 2018 per ASX Listing Rule 10.11, the entire outstanding principal balance under the 2018 Note and all unpaid accrued interest thereon was immediately convertible into CDIs, at the option of Crystal Amber at an initial conversion price of \$0.018 per CDI. Subsequently, the Company issued additional CDIs in an equity financing in September 2018 at a price per CDI of \$0.0144, resulting in an adjustment of the conversion price to \$0.0144 per CDI. Notice to convert the 2018 Note was provided by Crystal Amber, a Related Party on June 30, 2019. The 2018 Note converted to 134,852,549 CDIs (representing 2,697,050 shares of common stock). The principal of \$1.8 million converted to 121,527,778 CDIs (representing 2,430,555 shares of common stock) and the accrued interest of \$192 thousand converted to 13,324,772 CDIs (representing 266,495 shares of common stock). Upon the conversion of the 2018 Note, the Company also recorded \$1.4 million of unamortized interest expense related to the unamortized debt discount. As of June 30, 2019, the conversion of the CDIs had been executed, but not yet settled with the CDIs issued and available. The CDIs were issued on July 3, 2019 and have a one-year restriction on trading on the ASX.

On May 30, 2018, having secured stockholder pre-approval of the conversion features on May 24, 2018 per ASX Listing Rule 10.11, GI Dynamics issued to Crystal Amber a warrant (the “2018 Warrant”) to purchase 97,222,200 CDIs (representing 1,944,444 shares of common stock) at an initial exercise price of \$0.018 per CDI. As per the 2018 Note conversion price, the warrant exercise price was subsequently adjusted to \$0.0144 per CDI. The 2018 Warrant was exercised in full on August 25, 2019 for \$1.4 million.

The Company has evaluated the guidance ASC 480-10 *Distinguishing Liabilities from Equity*, ASC 815-40 *Contracts in an Entity's Own Equity* and ASC 470-20 *Debt with Conversion and Other Options* to determine the appropriate classification of the 2018 Note and 2018 Warrant. On issuance, the 2018 Warrant was determined to be a freestanding instrument meeting the requirements for equity classification. Accordingly, the fair value estimated for the 2018 Warrant, totaling approximately \$743 thousand, has been recorded as a discount to the debt with the offset to additional paid-in capital. The 2018 Note was also evaluated for a BCF subsequent to the allocation of proceeds among the 2018 Note and 2018 Warrant. Based upon the effective conversion price of the 2018 Note after considering the stock price at the date of issuance and the allocation of estimated fair value to the 2018 Warrant, it was determined that the 2018 Note contained a BCF. The value of the BCF was computed to be approximately \$1.2 million but has been capped at approximately \$1 million so as to not exceed the total proceeds from the 2018 Note after deducting the value allocated to the 2018 Note and 2018 Warrant. The effective interest rate on the note after the discounts is 26.4%.

The Company recorded the 2018 Note at issuance, net of the total debt discount of \$1.8 million and amortized the debt discount over the life of the 2018 Note. For the year ended December 31, 2019, the Company recognized interest expense of \$91 thousand and debt discount amortization of \$146 thousand, respectively. For the year ended December 31, 2018, the Company recognized interest expense of \$102 thousand, debt discount amortization of \$168 thousand and interest expense derived from issuance costs of \$85 thousand, respectively.

March 2019 Convertible Note and Warrant Financing

On March 15, 2019, the Company entered into a Note Purchase Agreement (“March 2019 NPA”) by and between the Company and Crystal Amber. Pursuant to the March 2019 NPA, the Company issued and sold to Crystal Amber a Senior Unsecured Convertible Promissory Note in an aggregate original principal amount of \$1.0 million (the “March 2019 Note”) with a maturity date of March 15, 2024. Interest accrued at an annually compounded rate of 10% per annum and issuance costs related to the March 2019 NPA were \$50 thousand.

After the Company obtained stockholder approval to enable Crystal Amber’s, a Related Party, conversion right under the March 2019 Note on June 30, 2019, the entire outstanding principal balance under the March 2019 Note and all unpaid accrued interest thereon was convertible into CDIs, at the option of Crystal Amber, a Related Party, at a conversion price of \$0.012 per CDI. On June 30, 2019, Crystal Amber, a Related Party, elected to convert the March 2019 Note into 81,070,003 CDIs (representing 1,621,400 shares of common stock) with the principal of \$1 million converting to 78,740,157 CDIs (representing 1,574,803 shares of common stock) and the accrued interest of approximately \$30 thousand converting to 2,329,846 CDIs (representing 46,596 shares of common stock). As of June 30, 2019, notice of the conversion had been provided by Crystal Amber and the CDIs were issued on July 3, 2019 and have a one-year restriction on trading on the ASX.

Per the March 2019 NPA, the Company contingently issued a warrant (the “March 2019 Warrant”) to Crystal Amber, pending stockholder approval, to purchase 78,984,823 CDIs (representing 1,579,696 shares of common stock) at an initial exercise price of \$0.0127 per CDI. The issue of the March 2019 Warrant required the approval of stockholders and was recorded as a derivative liability as it was not exercisable until its issue was approved on June 30, 2019. On August 25, 2019, a portion of the March 2019 Warrant totaling 47,244,119 CDIs (equivalent to approximately 944,882 shares of common stock) was exercised for \$600 thousand. The remaining portion of the March 2019 Warrant, totaling 31,740,704 CDIs (equivalent to 634,814 shares of common stock) was exercised for approximately \$400 thousand on September 30, 2019.

The Company evaluated the guidance ASC 480-10, *Distinguishing Liabilities from Equity*, ASC 815-40 *Contracts in an Entity’s Own Equity* and ASC 470-20 *Debt with Conversion and Other Options* to determine the appropriate classification of the March 2019 Note and March 2019 Warrant. On the date of the issuance of the March 2019 Note issuance the March 2019 Warrant was determined to be a freestanding instrument meeting the requirements for liability classification due to not having stockholder approval. Accordingly, the fair value estimated for the March 2019 Warrant, totaling approximately \$871 thousand, was recorded as a discount to the debt with the offset to derivative liabilities. No BCFs in respect of the March 2019 Note were present without stockholder approval.

Upon approval of the conversion features of the March 2019 Note and issuance of the warrants on June 30, 2019, the Company remeasured the warrant liability and recorded a \$576 thousand other expense to the consolidated statement of operations and then reclassified \$1.4 million of fair value of warrants from derivative liability to equity as the warrant became immediately exercisable. The Company then evaluated the March 2019 Note for a BCF. Based upon the effective conversion price of the March 2019 Note after considering the stock price at the date of stockholder approval and the allocation of estimated fair value to the March 2019 Warrant, it was determined that the March 2019 Note contained a BCF. The value of the BCF was computed to be approximately \$741 thousand but was capped at approximately \$265 thousand so as to not exceed the total proceeds from the March 2019 Note after deducting the value allocated to the March 2019 Note and 2019 Warrant. The relative fair value of the warrant upon stockholder approval was approximately \$735 thousand. The total debt discount on the March 2019 Note upon stockholder approval of its conversion feature was \$1 million. The effective interest rate on the Note after the discounts was 29.4%.

On the June 30, 2019 conversion of the March 2019 Note, an unamortized debt discount of \$1 million was recorded as interest expense. The March 2019 Note principal of \$1 million and accrued interest of \$30 thousand were transferred to common stock subscribed but unissued.

For the year ended December 31, 2019, the Company recognized accrued interest expense of \$30 thousand and debt discount amortized to interest expense of \$109 thousand, respectively.

May 2019 Convertible Note and Warrant Financing

On May 8, 2019, the Company entered into a Note Purchase Agreement (“May 2019 NPA”) by and between the Company and Crystal Amber. Pursuant to the May 2019 NPA, the Company issued and sold to Crystal Amber a Senior Unsecured Convertible Promissory Note in an aggregate original principal amount of \$3.0 million (the “May 2019 Note”)

with a maturity date of May 8, 2024. Interest accrued at an annually compounded rate of 10% per annum and issuance costs related to the March 2019 NPA were \$34 thousand.

After the Company obtained stockholder approval to enable Crystal Amber's, a Related Party, conversion right under the May 2019 Note on June 30, 2019, the entire outstanding principal balance under the May 2019 Note and all unpaid accrued interest thereon was convertible into CDIs, at the option of Crystal Amber at a conversion price of \$0.0127 per CDI. On June 30, 2019, Crystal Amber elected to convert the May 2019 Note into 237,687,411 CDIs (representing 4,753,748 shares of common stock). The principal of \$3.0 million converted to 236,220,472 CDIs (representing 4,724,409 shares of common stock) and the accrued interest of approximately \$19 thousand converted to 1,466,939 CDIs (representing 29,338 shares of common stock). As of June 30, 2019, notice of the conversion had been provided by Crystal Amber and the CDIs were issued on July 3, 2019 and have a one-year restriction on trading on the ASX.

Per the March 2019 NPA, the Company contingently issued a warrant (the "March 2019 Warrant") to Crystal Amber, pending stockholder approval, to purchase 236,220,472 CDIs (representing 4,724,409 shares of common stock) at an initial exercise price of \$0.0127 per CDI. The issue of the May 2019 Warrant required the approval of stockholders and was recorded in derivative liability as it was not exercisable until its issue was approved on June 30, 2019. A portion of the May 2019 Warrant totaling 125,739,610 CDIs (equivalent to 2,514,792 shares of common stock) was exercised by Crystal Amber for approximately \$1.6 million on September 30, 2019. Another portion of the May 2019 Warrant totaling 78,740,157 CDIs (equivalent to 1,574,803 shares of common stock) was exercised by Crystal Amber for approximately \$1 million on October 31, 2019.

The Company evaluated the guidance ASC 480-10 *Distinguishing Liabilities from Equity*, ASC 815-40 *Contracts in an Entity's Own Equity* and ASC 470-20 *Debt with Conversion and Other Options* to determine the appropriate classification of the May 2019 Note and May 2019 Warrant. On the date of the issuance of the May 2019 Note issuance the May 2019 Warrant was determined to be a freestanding instrument meeting the requirements for liability classification due to not having stockholder approval. Accordingly, the fair value estimated for the May 2019 Warrant, totaling approximately \$3.2 million, was limited to the value relative to the debt of \$1.7 million, which was recorded as a discount to the debt with the offset to derivative liabilities. No BCFs in respect of the May 2019 Note were present without stockholder approval.

Upon approval of the conversion features of the May 2019 Note and issuance of the May 2019 Warrant on June 30, 2019, the Company revalued the warrant liability and recorded a \$1.1 million other expense to the consolidated statements of operations and then reclassified approximately \$4.3 million of fair value of warrants from derivative liability to equity as the May 2019 Warrant became immediately exercisable. The Company then evaluated the May 2019 Note for a BCF. Based upon the effective conversion price of the May 2019 Note after considering the stock price at the date of stockholder approval and the allocation of estimated fair value to the May 2019 Warrant, it was determined that the May 2019 Note contained a BCF. The value of the BCF was computed to be approximately \$2 million but was not recorded as doing so would exceed the total proceeds from the May 2019 Note after deducting the value allocated to the May 2019 Note and May 2019 Warrant. The relative fair value of the May 2019 Warrant upon stockholder approval was approximately \$2.1 million. The total debt discount on the May 2019 Note upon stockholder approval was \$3 million. The effective interest rate on the May 2019 Note after the discounts is 29.4%.

On the June 30, 2019 conversion of the May 2019 Note, unamortized debt discount of \$3 million was recorded as interest expense. The May 2019 Note principal of \$3 million and accrued interest of \$19 thousand were transferred to common stock subscribed but unissued.

For the year ended December 31, 2019, the Company recognized accrued interest expense of \$19 thousand and debt discount amortized to interest expense of \$152 thousand, respectively.

August 2019 Securities Purchase Agreement

On August 21, 2019, the Company entered into the August 2019 SPA by and between the Company and Crystal Amber. The August 2019 SPA detailed a timeline wherein Crystal Amber would exercise the 2018 Warrant, the March 2019 Warrant, and the May 2019 Warrant. Additionally, pursuant to the August 2019 SPA, the Company issued and sold to Crystal Amber a senior unsecured convertible promissory note in an aggregate principal amount of approximately \$4.6 million, or such lesser amount as may be set forth in a notice delivered by the Company to Crystal Amber (the "August 2019 Note"), to be funded on December 6, 2019, or such earlier or later date as may be requested by the Company (the "Funding Date"). In conjunction with the August 2019 Note, the Company agreed to issue to Crystal Amber the August 2019 Warrant to purchase CDIs, subject to the receipt of required stockholder approval approving the issuance of the

August 2019 Warrant and the funding of the August 2019 Note (For a detailed description of the exercises and the terms of the exiting warrants and for a description of the August 2019 Warrant, see *Note 4 Warrants to purchase common stock and CDIs*)

The August 2019 Note accrues interest at a rate equal to 10% per annum from the Funding Date, compounded annually, other than during the continuance of an event of default, when the August 2019 Note accrues interest at a rate of 16% per annum. The entire outstanding principal balance and all unpaid accrued interest thereon is due on the fifth anniversary of the Funding Date. Subject to the receipt of stockholder approval as required by Rule 10.11 of the ASX Listing Rules, the entire outstanding principal balance under the August 2019 Note and all unpaid accrued interest thereon is convertible into CDIs at the option of Crystal Amber at a conversion price equal to US\$0.02 per CDI. In the event that the Company issues additional CDIs to a stockholder other than Crystal Amber in a subsequent equity financing at a price per CDI that is less than the conversion price under the August 2019 Note, the conversion price shall be reduced to the lowest such price per CDI. In addition, upon a change of control of the Company, Crystal Amber may, at its option, demand that the Company prepay all accrued and unpaid interest plus 110% of the remaining outstanding unconverted principal balance. The Company may not prepay the August 2019 Note without the consent of Crystal Amber, a Related Party. If the stockholder approvals required to issue the August 2019 Warrant or to approve the conversion rights under the August 2019 Note are not obtained, the Company is obligated to prepay all accrued and unpaid interest plus 110% of the remaining outstanding unconverted principal balance on the earlier of the Funding Date or the date that is six months following the date of the stockholder meeting at which the requisite approvals were not obtained.

The August 2019 SPA contains customary events of default. If a default occurs and is not cured within the applicable cure period or is not waived, any outstanding obligations under the August 2019 Note may be accelerated. The August 2019 SPA and related August 2019 Note and August 2019 Warrant documents also contain additional representations and warranties, covenants and conditions, in each case customary for transactions of this type.

Prior to December 6, 2020, GI Dynamics notified Crystal Amber that it had elected to receive the full amount of approximately \$4.6 million under the August 2019 Note, but agreed to timing extensions.

On December 16, 2019, stockholder approval was obtained pursuant to ASX Listing Rule 10.11, for the August 2019 Note conversion feature and the issuance of the August 2019 Warrant, contingent on receipt of the August 2019 Note proceeds.

On January 13, 2020, the full amount of approximately \$4.6 million was received as proceeds from the August 2019 Note. On receipt of funds, the August 2019 Note conversion feature was immediately available to Crystal Amber.

11. Commitments and Contingencies

Lease Commitments

In June 2016, the Company entered into a non-cancelable agreement to lease approximately 4,200 square feet of office space in Boston, Massachusetts. The lease commenced in June 2016 and expired in April 2018. Rent during the term was approximately \$12 thousand per month.

In December 2018, the Company entered into a 6-month membership agreement with WeWork for 985 square feet of office space located in Boston, Massachusetts. The committed lease term expired in May 2019 and contained a two-month cancellation provision. The WeWork agreement contained no explicit or guaranteed extension provisions.

On April 22, 2019, the Company entered into a right-of-use lease for 3,520 square feet of office space in Boston, Massachusetts. The lease period contractually commenced June 1, 2019 and expires on May 31, 2022, but the space was available for occupancy on May 1, resulting in an effective period of May 2019 through May 2022, with no rent payment assessed in May 2019. The lease has defined escalating rent payments and contains no extension or expansion rights. On lease execution, the Company recorded the approximately \$497 thousand present value of the lease liability in short-term and long-term liabilities and recorded a related right-of-use asset. The right-of-use asset will be amortized to lease expense and the liability will be reduced by the rent payments over the term of the lease.

The Company's leases generally do not provide an implicit interest rate and therefore the Company uses 10% as an estimate of its incremental borrowing rate as the discount rate when measuring operating lease liabilities. The incremental borrowing rate represents an estimate of the interest rate the Company would incur at lease commencement to borrow an amount equal to the lease payments on a collateralized basis over the term of a lease in a similar economic environment.

The Company had no leases currently classified as finance leases or previously classified as capital leases in either reporting period.

The following table presents supplemental balance sheet information related to the Company's operating lease:

	December 31,	
	2019	2018
	(in thousands)	
Right-of-use assets, net of amortization	\$ 415	\$ —
Liabilities	—	—
Short-term operating lease liabilities	\$ 181	\$ —
Long-term operating lease liabilities	234	—
Total liabilities	\$ 415	\$ —

Other information related to leases was as follows:

	December 31,	
	2019	2018
	(in thousands)	
Operating cash flows from operating leases in lease liability measurement	\$ 148	\$ —
Operating cash flows from short term leases	103	—
Remaining long-term lease term in years	2.4	—
Discount rate	10%	—

The maturity of the Company's finance and operating lease liabilities as of December 31, 2019 and 2018 are as follows:

	December 31,	
	2019	2018
	(in thousands)	
Year ending December 31,		
2020	191	—
2021	195	—
2022	98	—
Total future minimum lease payments	484	—
Less: imputed interest	69	—
Total liabilities	\$ 415	\$ —

Rent expense on non-cancelable operating leases was approximately \$200 and \$100 thousand for the years ended December 31, 2019 and 2018, respectively.

12. Stockholders' Deficit

On April 9, 2015, GI Dynamics amended its certificate of incorporation to reflect the one-for-ten reverse stock split approved by its stockholders.

On May 22, 2017, GI Dynamics Stockholders approved an increase of its authorized shares of common stock from 13 million to 50 million and to eliminate Class B shares of common stock of the Company.

On December 19, 2019, GI Dynamics stockholders approved an increase of its authorized shares of common stock from 50 million to 75 million.

As of December 31, 2019, the authorized capital stock of the Company consists of 75.5 million shares, of which 75 million shares are designated as common stock and 500 thousand shares are designated as preferred stock.

In 2018, the Company received commitments for two private placements to sophisticated and professional investors in Australia, the United States and the United Kingdom, consisting of U.S. and non-U.S. persons (as defined in Regulation S (“Regulation S”) of the Securities Act of 1933 (the “Securities Act”) to raise up to approximately \$6.6 million (the “2018 Placements”). The first placement (“First Quarter 2018 Placement”) consisted of a total of 58,780,619 fully paid CDIs of the Company (representing 1,175,612 shares of common stock) at an issue price of A\$0.035 per CDI. The issue of CDIs under the First Quarter 2018 Placement occurred in two tranches. The first tranche closed on January 22, 2018 (US EST), pursuant to which the Company issued 28,467,063 CDIs (representing 569,341 shares of common stock) resulting in gross proceeds of approximately \$781 thousand and related issuance costs of \$63 thousand. The closing of the second tranche of the First Quarter 2018 Placement resulted in the raising of \$824 thousand and related issuance costs of \$40 thousand by the issue of 30,313,556 CDIs (representing 606,271 shares) following stockholder approval granted on February 27, 2018. There were two participants in the First Quarter 2018 Placement second tranche; Crystal Amber Fund, a related party for ASX purposes, purchased 27,391,756 CDIs. A Board member of the Company purchased 2,921,800 CDIs.

The second placement (“Autumn 2018 Placement”) consisted of a total of 347,222,250 fully paid CDIs of the Company (representing 6,944,445 shares of common stock) at an issue price of A\$0.020 per CDI. The investors in the Autumn 2018 Placement included certain existing investors. The issue of these CDIs occurred in two tranches. The first tranche closed on September 20, 2018 (US EST), pursuant to which the Company issued 150,000,000 CDIs (representing 3,000,000 shares of common stock) resulting in gross proceeds of approximately \$2.2 million and related issuance costs of \$56 thousand. The closing of the second tranche resulted in the raising of \$2.8 million and related issuance costs of \$12 thousand by the issue of 197,222,250 CDIs (representing 3,944,445 shares of common stock) following stockholder approval at the adjourned Special Meeting of stockholders on October 29, 2018. There were three participants in the second tranche; Crystal Amber Fund, a related party for ASX purposes, purchased 168,194,450 CDIs. Existing investors in the United States and Australia also purchased 23,819,450 and 5,208,350 CDIs, respectively. All second tranche CDIs were allotted to investors in November 2018.

On June 30, 2019, Crystal Amber converted the 2018 Note to 134,852,549 CDIs (representing 2,697,050 shares of common stock). The principal of \$1.8 million converted to 121,527,778 CDIs (representing 2,430,555 shares of common stock) and the accrued interest of \$192 thousand converted to 13,324,772 CDIs (representing 266,495 shares of common stock).

On June 30, 2019, Crystal Amber converted the March 2019 Note to 81,070,003 CDIs (representing 1,621,400 shares of common stock). The principal of \$1 million converted to 78,740,157 CDIs (representing 1,574,803 shares of common stock) and the accrued interest of approximately \$30 thousand converted to 2,329,846 CDIs (representing 46,596 shares of common stock).

On June 30, 2019, Crystal Amber converted the May 2019 Note to 237,687,411 CDIs (representing 4,753,748 shares of common stock). The principal of \$3 million converted to 236,220,472 CDIs (representing 4,724,409 shares of common stock) and the accrued interest of approximately \$19 thousand converted to 1,466,939 CDIs (representing 29,338 shares of common stock).

On August 25, 2019, Crystal Amber exercised the 2018 Warrant totaling 97,222,200 CDIs (representing 1,944,444 shares of common stock) and a portion of the March 2019 Warrant totaling 47,244,119 CDIs (equivalent to approximately 944,882 shares of common stock) for an aggregate cash payment of \$2 million.

On September 30, 2019, Crystal Amber exercised the remaining March 2019 Warrant totaling 31,740,704 CDIs (equivalent to 634,814 shares of common stock) and a portion of the May 2019 Warrant totaling 125,739,610 CDIs (equivalent to 2,514,792 shares of common stock) for an aggregate cash payment of \$2 million. As of September 30, 2019, this was recorded as common stock – subscribed but unissued and the cash was received on October 1, 2019.

On October 31, 2019, Crystal Amber exercised another portion of May 2019 Warrant totaling 78,740,157 CDIs (equivalent to approximately 1,574,803 shares of common stock) for an aggregate cash payment of \$1 million. Cash was received on October 31, 2019.

On November 15, 2019, Crystal Amber exercised the final portion of May 2019 Warrant totaling 31,740,704 CDIs (equivalent to approximately 634,814 shares of common stock) for an aggregate cash payment of approximately \$403 thousand. Cash was received on November 15, 2019.

Common Stock

On December 19, 2019, GI Dynamics stockholders approved an increase in the number of common shares, par value \$0.01 per share, available for issuance from 50 million shares to 75 million shares.

The Company had authorized Class B common stock in order to meet the Listing Rules of the ASX so far as they apply to escrowed securities. In the event that holders of common stock, who were subject to ASX-imposed escrow, breached the terms of their escrow agreement or the Listing Rules as they apply to escrowed securities, their common stock would have been automatically converted into Class B common stock until the earlier to occur of the expiration of the escrow period or the breach being rectified. The Class B common stock was identical to and ranked equally with the common stock except that Class B common stock had no voting rights and was not entitled to any dividends. Class B common stock of the Company was eliminated on May 22, 2017. No shares of common stock were subject to such an escrow.

13. Share-Based Compensation

The Company has two stock-based compensation plans. The Board of Directors adopted the 2003 Omnibus Stock Plan (the “2003 Plan”), which provides for the grant of qualified incentive stock options and nonqualified stock options or other awards to the Company’s employees, officers, directors, advisors, and outside consultants to purchase up to an aggregate of 922,086 shares of the Company’s common stock.

In August 2011, the Board of Directors adopted the 2011 Employee, Director and Consultant Equity Incentive Plan (the “2011 Plan”, together with the 2003 Plan, the “Plans”) as the successor to the 2003 Plan. Under the 2011 Plan, the Company may grant incentive stock options, nonqualified stock options, restricted and unrestricted stock awards and other stock-based awards. The Company had initially reserved 450 thousand shares of its common stock for issue under the 2011 Plan. Awards that are returned to the Company’s 2003 Plan as a result of their forfeiture, expiration or cancellation without delivery of common stock shares or that result in the forfeiture of shares back to the Company on or after August 1, 2011, the date the 2011 Plan became effective, are automatically made available for issuance under the 2011 Plan. At August 1, 2011, 80,235 shares available for grant under the 2003 Plan were transferred to the 2011 Plan. As of December 31, 2019, an additional 1,173,917 shares of common stock were available for grant under our 2011 Employee, Director and Consultant Equity Incentive Plan.

In addition, the 2011 Plan allows for an annual increase in the number of shares available for issue under the 2011 Plan commencing on the first day of each fiscal year during the period beginning in fiscal year 2012 and ending in fiscal year 2020. The annual increase in the number of shares shall be equal to the lowest of:

- 500 thousand shares;
- 4% of the number of common shares outstanding as of such date; and
- an amount determined by the Board of Directors or the Company’s compensation committee. Accordingly, during year ended December 31, 2019 and December 31, 2018, 500 thousand and 0 shares were added to the 2011 Plan, respectively.

Stock-Based Compensation

Stock-based compensation is reflected in the consolidated statements of operations as follows for the years ended December 31, 2019 and 2018 (in thousands):

	Years Ended December 31,	
	2019	2018
Research and development	\$ 63	\$ 6
Sales and marketing	—	23
General and administrative	170	95
	<u>\$ 233</u>	<u>\$ 124</u>

The stock options granted under the plans generally vest over a four-year period and expire ten years from the date of grant. From time to time, the Company grants stock options to purchase common stock subject to performance-based milestones. The vesting of these stock options will occur upon the achievement of certain milestones. When achievement of the milestone is deemed probable, the Company expenses the compensation of the respective stock option over the implicit service period.

In calculating stock-based compensation costs, the Company estimates the fair value of stock options using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of short-lived, exchange-traded options that have no vesting restrictions and are fully transferable. The Company estimates the number of awards that will be forfeited in calculating compensation costs. Such costs are then recognized over the requisite service period of the awards on a straight-line basis.

Determining the fair value of stock-based awards using the Black-Scholes option-pricing model requires the use of highly subjective assumptions, including the expected term of the award and expected stock price volatility. The weighted-average assumptions used to estimate the fair value of employee stock options using the Black-Scholes option-pricing model were as follows for the years ended December 31, 2019 and 2018:

	Years Ended December 31,	
	2019	2018
Expected volatility	271.0%	120.7%
Expected term (in years)	6.05	6.05
Risk-free interest rate	1.8%	2.6%
Expected dividend yield	0%	0%

Expected Volatility

Volatility measures the amount that a stock price has fluctuated or is expected to fluctuate during a period. As the Company was not publicly traded prior to September 2011 and therefore had no trading history, stock price volatility was estimated based on an analysis of historical and implied volatility of comparable public companies.

Expected Term

The Company has limited historical information to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior for its stock option grants. As a result, for stock option grants made during the years ended December 31, 2019 and 2018, the expected term was estimated using the “simplified method.” The simplified method is based on the average of the contractual term of the option and the weighted-average vesting period of the option. For options granted to non-employees, the Company used the remaining contractual life to estimate the expected term of non-employee awards for the years ended December 31, 2019 and 2018.

Risk-Free Interest Rate

The risk-free interest rate used for each grant is based on a zero-coupon U.S. Treasury instrument with a remaining term similar to the expected term of the stock-based award.

Expected Dividend Yield

The Company has not paid and does not anticipate paying cash dividends on its shares of common stock in the foreseeable future; therefore, the expected dividend yield is assumed to be zero.

Stock Options

The following table summarizes share-based activity under the Company's stock option plans:

	Shares of Common Stock Attributable to Options	Weighted- Average Exercise Price	Weighted- Average Contractual Life	Aggregate Intrinsic Value
			(in years)	(in thousands)
Outstanding at December 31, 2018	1,142,883	\$ 2.24	8.48	63
Granted	1,994,771			
Exercised	—			
Cancelled	(41,500)			
Outstanding at December 31, 2019	3,096,154			—
Vested or expected to vest at December 31, 2019	3,096,154			—
Exercisable at December 31, 2019	685,015			—

Restricted Stock Units & Performance Stock Units

Each restricted stock unit and performance stock unit ("RSU & PSU") represents a contingent right to receive one share of the Company's common stock. There is no consideration payable on the vesting of RSUs & PSUs issued under the Plans. Upon vesting, the RSUs & PSUs are exercised automatically and settled in shares of the Company's common stock. During the years ended December 31, 2019 and 2018, the Company awarded no RSUs & PSUs, to employees and directors of the Company. Due to the resignation of an employee, one grant of 142,659 RSU & PSU was cancelled in 2018.

The following table summarizes information related to RSU & PSU activity during the year ended December 31, 2019:

	Number of Units	Weighted- Average Contractual Life	Aggregate Intrinsic Value
		(in years)	(in thousands)
Outstanding at December 31, 2018	250,000	7.23	\$ 141
Granted	—		
Exercised	—		
Cancelled	—		
Outstanding at December 31, 2019	250,000		\$ 149

The aggregate intrinsic value at December 31, 2019 and 2018 noted in the table above represents the closing price of the Company's common stock multiplied by the number of RSUs & PSUs outstanding. The fair value of each RSU & PSU award equals the closing price of the Company's common stock on the date of grant.

At December 31, 2019, 250,000 of the RSUs & PSUs outstanding are subject to performance-based vesting criteria. For these awards, the vesting will occur upon the achievement of certain milestones. When achievement of the milestone is deemed probable, the Company will expense the compensation of the respective stock award over the implicit service period.

During the years ended December 31, 2019 and 2018, the Company recognized no stock-based compensation related to RSUs & PSUs performance-based vesting.

As of December 31, 2019, there was approximately \$200 thousand of unrecognized stock-based compensation expense related to non-vested RSU & PSU awards that have service-based vesting.

Non-employee awards

The Company accounts for non-employee awards in accordance with ASC 505-50. Stock-based compensation expense related to stock options granted to non-employees is recognized as services are rendered, generally on a straight-line basis. The Company believes that the fair value of the stock options is more reliably measurable than the fair value of the services rendered. The fair value of the stock options granted is remeasured at each reporting date using the Black-Scholes option pricing model as prescribed by ASC 718. During the year ended December 31, 2019 and 2018, the Company granted 120 thousand and no options to purchase shares of common stock to non-employees.

The Company has recorded non-employee stock-based compensation expense in accordance with ASC 505-50 of approximately \$26 thousand and \$20 thousand during the years ended December 31, 2019 and 2018, respectively, which is included in the total stock-based compensation expense.

14. Segment Reporting

The Company has one reportable segment which designs, develops, manufactures and markets medical devices for non-surgical approaches to treating type 2 diabetes.

Geographic Reporting

GI Dynamics does not report geographic segments as there were no product sales in 2019 or 2018 and at December 31, 2019 and 2018, all long-lived assets comprised of property and equipment were held in the U.S.

15. Retirement Plans

The Company has a 401(k) retirement and savings plan (“401(k) Plan”) covering all qualified U.S. employees. The 401(k) Plan is a defined contribution plan and allows each participant to contribute up to 100% of the participant’s base wages up to an amount not to exceed an annual statutory maximum. The Company has made discretionary contributions to the 401(k) Plan and recorded expenses of approximately \$48 and \$24 thousand for the years ended December 31, 2019 and 2018, respectively.

The Company maintains a defined contribution plan for certain international employees. The Company contributes 100% of the cost of the defined contribution. The Company recorded expenses of approximately \$27 thousand and \$24 thousand for the years ended December 31, 2019 and 2018, respectively, under this plan.

16. Income Taxes

Loss before provision for income taxes consisted of the following (in thousands):

	Years Ended December 31,	
	2019	2018
Domestic	\$ (17,346)	\$ (8,054)
Foreign	87	29
Total	<u>\$ (17,259)</u>	<u>\$ (8,025)</u>

The provision for income taxes in the accompanying consolidated statements of operations and comprehensive loss consisted of the following (in thousands):

	Years Ended December 31,	
	2019	2018
Current Provision:		
Federal	\$ —	\$ —
State	1	1
Foreign	42	13
Total	43	14
Deferred (Benefit) Provision:		
Federal	—	—
State	—	—
Foreign	3	(1)
Total	3	(1)
Total provision	<u>\$ 46</u>	<u>\$ 13</u>

A reconciliation of income taxes from operations computed using the U.S. federal statutory rate of 21% to that reflected in operations follows (in thousands):

	Years Ended December 31,	
	2019	2018
Income tax benefit using U.S. federal statutory rate	\$ (3,624)	\$ (1,675)
State rate, net of federal benefit	(631)	(438)
Permanent differences	1,422	40
Tax credits generated	(147)	(45)
Change in valuation allowance	2,888	2,041
Foreign rate differential	4	3
Other items	96	63
Stock compensation	38	24
Total	<u>\$ 46</u>	<u>\$ 13</u>

Components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	2019	2018
Deferred tax assets:		
Net operating loss carryforwards	\$ 66,859	\$ 63,881
Research and development credit carryforwards	4,083	4,026
Capitalized research and development costs	-	123
Capitalized start-up expenses	2,133	2,490
Depreciation and other	635	305
Total deferred tax assets	73,710	70,825
Valuation allowance	(73,703)	(70,815)
Net deferred tax asset	<u>\$ 7</u>	<u>\$ 10</u>

Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of the Company's deferred tax assets and determined that it is more likely than not that the Company will not recognize the benefits of the deferred tax assets related to the U.S. As a result, a valuation allowance of approximately \$73.7 million and \$70.8 million was established at December 31, 2019 and 2018, respectively. The valuation allowance increased by approximately \$2.9 million during the year ended December 31, 2019, primarily due to the current year change in temporary tax items. During the period ending December 31, 2019, the Company will utilize all remaining net operating losses in the Netherlands and therefore has no deferred tax asset or valuation allowance as of December 31, 2019 in the Netherlands. As of December 31, 2019, there was a net deferred tax asset in Australia related to future tax benefits which will offset future taxable income.

At December 31, 2019, the Company had U.S. federal and state net operating loss carryforwards of approximately \$248.8 million and \$231.1 million, respectively. These operating loss carryforwards will expire at various times beginning in 2024 through 2038 for federal purposes and begin to expire in 2030 and will continue to expire through 2039 for state purposes. The \$25.8 million net operating losses incurred in 2018 and 2019 can be carried forward indefinitely for federal purposes.

In addition, at December 31, 2019, the Company also has U.S. federal and state research and development tax credit carryforwards (excluding ASC 740, *Income Taxes* ("ASC 740"), reserve) of approximately \$3.8 million and \$2.0 million, respectively, to offset future income taxes. These tax credit carryforwards will expire at various times beginning in 2023 through 2038 for federal purposes and will expire at various times beginning in 2019 through 2034 for state purposes.

Utilization of net operating loss carryforwards and research and development credit carryforwards may be subject to a substantial annual limitation due to ownership change limitations that have occurred previously or that could occur in the future in accordance with Section 382 of the Internal Revenue Code of 1986 ("IRC Section 382") and with Section 383 of the Internal Revenue Code of 1986, as well as similar state provisions. These ownership changes may limit the amount of net operating loss carryforwards and research and development credit carryforwards that can be utilized annually to offset future taxable income and taxes, respectively. In general, an ownership change, as defined by IRC Section 382, results from transactions increasing the ownership of certain stockholders or public groups in the stock of a corporation by more than 50 percentage points over a three-year period. The Company has completed several financings since its inception, which may have resulted in a change in control as defined by IRC Section 382 or could result in a change in control in the future. As of December 31, 2019, the Company has not, as yet, conducted an IRC Section 382 study, which could impact its ability to utilize net operating loss and tax credit carryforwards annually in the future to offset the Company's taxable income, if any.

The Company applies ASC 740-10, which provides guidance on the accounting for uncertainty in income taxes recognized in financial statements and requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. When uncertain tax positions exist, the Company recognizes the tax benefit of tax positions to the extent that the benefit will more likely than not be realized. The determination as to whether the tax benefit will more likely than not be realized is based upon the technical merits of the tax position as well as consideration of the available facts and circumstances. At December 31, 2019 and 2018, the Company had unrecognized tax liabilities of approximately \$1.5 million and \$1.5 million, respectively.

The following is a roll forward of the Company's unrecognized tax benefits (in thousands):

	December 31,	
	2019	2018
Unrecognized tax benefit – as of the beginning of the year	\$ 1,462	\$ 1,481
Gross decreases – provision to return tax positions of the prior periods	(21)	(35)
Gross increases – current period tax positions	39	16
Unrecognized tax benefits – as of the end of the year	\$ 1,480	\$ 1,462

The Company will recognize interest and penalties related to uncertain tax positions, should they be assessed, in income tax expense. As of December 31, 2019, and 2018, the Company had no accrued interest or penalties related to uncertain tax positions, and no amounts have been recognized in the Company's consolidated statements of comprehensive loss.

The statute of limitations for assessment by the Internal Revenue Service ("IRS") and state tax authorities is open for tax years ended December 31, 2015 through December 31, 2019, although carryforward attributes that were generated prior to tax year 2015 may still be adjusted upon examination by the IRS or state tax authorities if they either have been or will be used in a future period. The statute of limitations for assessment by foreign tax authorities is open for tax years ended December 31, 2015 through December 31, 2019. There are currently no federal or state audits in progress.

The Company has not yet completed a study of its research and development credit carryforwards. Once completed, this study may result in an adjustment to the Company's research and development credit carryforwards. A full valuation allowance has been provided against the Company's research and development credits, and if an adjustment is required at the time the study is completed, this adjustment would be offset by an adjustment to the deferred tax asset established for the research and development credit carryforward and the valuation allowance.

17. Subsequent Events

On January 13, 2020, GI Dynamics received approximately \$4.6 million pursuant to the August 2019 Note. On receipt of funds, the August 2019 Note became convertible per the August 2019 Note terms (as disclosed within the relevant footnotes above), and GI Dynamics issued the August 2019 Warrant (as disclosed within the relevant footnotes above).